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THE REGULATORY STATUS OF BROADBAND SERVICES: INFORMATION SERVICES, COMMON CARRIAGE, OR SOMETHING IN BETWEEN?

HEARING

BEFORE THE

SUBCOMMITTEE ON TELECOMMUNICATIONS AND THE INTERNET

OF THE

COMMITTEE ON ENERGY AND COMMERCE

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THE REGULATORY STATUS OF BROADBAND SERVICES: INFORMATION SERVICES, COMMON CARRIAGE, OR SOMETHING IN BETWEEN?

MONDAY, JULY 21, 2003

HOUSE OF REPRESENTATIVES,
COMMITTEE ON ENERGY AND COMMERCE,
SUBCOMMITTEE ON TELECOMMUNICATIONS
AND THE INTERNET,
Washington, DC.

The subcommittee met, pursuant to notice, at 3:05 p.m., in room 2123, Rayburn House Office Building, Hon. Fred Upton (chairman) presiding.

Members present: Representatives Upton, Stearns, Shimkus, Walden, Tauzin (ex officio); Markey, Davis, Engel, Wynn, and Dingell (ex officio).

Staff present: Howard Waltzman, majority counsel; Will Nordwind, majority counsel and policy coordinator; Will Carty, legislative clerk; Gregg Rothschild, minority counsel; and Peter Filon, minority Counsel.

Mr. UPTON. Good afternoon.

To a casual observer, the discussions of Title I and Title II and classifications of broadband as either a telecommunications service or an information service may seem mind-numbingly arcane. However, the distinctions are critically important, and the FCC's decisions in this regard may have a profound effect on our Nation's consumers and our economy.

On July 15, Alan Greenspan suggested that corporate executives are still sitting out this recovery. He seemed to suggest that everyone else is on board the flight, but businesses remain in the waiting area. We need to ask why this is the case in the telecommunications sector.

The short answer is that outmoded regulation is getting in the way of investment in broadband deployment. The FCC needs to act now, and I hope that the FCC is listening, because I expect to have the Commission back shortly after we return in September and we will be asking them to explain if they have not acted by then.

Our Nation's economy is hanging in the balance. I commend Chairman Powell for his vision and efforts to create a national broadband policy. I share that vision, and I believe that it should be accomplished through deregulatory parity, not regulatory parity, and I have said that a number of times.

In my view, we should endeavor to provide the same deregulatory treatment to all broadband services, regardless of the platform by which they are delivered. We need to knock down regulatory barriers which are stifling incentives to invest if we are to bring the promise of broadband to the American people and realize the economic stimulus which this will create. In fact, some experts suggest that the widespread adoption of broadband will increase the efficiency and productivity in the American workplace to the tune of half a trillion dollars.

Of course, the multiplier effect of investment in the telecommunications sector is enormous. Every dollar of investment in telecommunications infrastructure results in almost $3 in economic output.

In February, the Commission announced the results of its Triennial Review. Five months later, the Commission still has not issued its order. It seems that the Commission is moving at dial-up speeds. Nevertheless, I am cautiously optimistic that the Commission's order once issued will remove significant regulatory shackles from the backs of the ILEC's broadband facilities. This would be a welcome regulatory change, and it will promote investment in broadband which will be good for the consumer and the economy.

Today we will turn our attention to two proceedings which will determine how broadband services offered by telephone companies and cable companies are defined. These proceedings will also have a significant bearing on whether we create the right incentives to invest in broadband and promote real competition.

So far, the Commission has declared that broadband services provided by cable companies are information services, not telecommunications services. The Commission is right on the mark, both as a matter of policy and as a matter of law. Moreover, the Commission has tentatively concluded that broadband services provided by phone companies are also information services, not telecommunications services; and I hope that the Commission continues down the same logistical path in this proceeding as it did in the cable broadband proceeding and removes the tentiveness of this conclusion.

What such classifications would promote is the notion that old legacy telephone regs are simply not appropriate for broadband services, particularly given that there are numerous technological platforms by which broadband services are delivered, and it makes no sense to tie one hand behind the backs of the telephone companies seeking to provide the same service as the cable companies or, for that matter, satellite TV companies, wireless companies or, hopefully in the not-too-distant future, power line carrier companies.

Again, this is not to suggest that we should tie one hand behind the back of all other broadband service providers to put them on the same regulatory playing field of the telephone companies either. That would be a big mistake. What we need is deregulatory parity, and we need both Federal and State regulators to be involved in promoting real competition and stimulating investment in the broadband marketplace.

I am convinced that this would create real, sustainable economic growth, provide the jobs and ensure the most competitive broadband marketplace which would lead to the most rapid deployment of broadband to the American people. Now is the time for the FCC to act. We will hear from the FCC today, and I look forward to hearing from the Commission again this fall, and the news, I hope, better be good.

I yield to the ranking member of the subcommittee, Mr. Markey.

Mr. MARKEY. Thank you, Mr. Chairman, very much, and thank you for putting together this extremely distinguished panel.

I am glad to see Mr. Tauke's name elevated in the center of the panel, reflecting the exalted status which he holds and the memory of this committee as a former member of it. Although I would say that the concomitant reality is not true for you, Mr. Misener, and your status. That is unrelated to why you are sitting at that table, and we also hold Amazon in very high status as well.

The purpose of this hearing, Mr. Chairman, is to discuss the regulatory classification that should be accorded to broadband access to the Internet, whether it is over a cable facility or over a telephone wire. There are some who assert that such services are information services, others who stipulate that they are telecommunications services. The distinction in nomenclature is important, because the providers of information services have differing legal and regulatory obligations than those entities providing telecommunications services.

Information services are largely unregulated, as opposed to providers of telecommunications services. Providers of information services do not currently have the universal service, consumer privacy, law enforcement, interconnection, unbundling or resale obligations that telecommunications carriers have, just to name a few items.

By recently classifying broadband access to the Internet over cable systems as an interstate information service, the FCC took jurisdiction away from State regulators and local franchising authorities for such services offered by cable operators and rendered cable modem broadband services unregulated.

The telephone companies, who compete with cable broadband offerings in the residential marketplace with their DSL offerings, correctly point out that their service is comparable to that offered by cable operators. It certainly is similar in the eyes of millions of consumers.

DSL services are fungible substitutes in the marketplace for cable broadband offerings. They are marketed as competing products, and they are essentially priced the same.

The fact that the telephone companies seek equal treatment for cable, modem and DSL offerings is understandable. They should be treated the same way. The phone company's desire to achieve parity by deregulating down to the unregulated offerings of the cable industry is also a perfectly understandable goal from their point of view. The law compels parity and like treatment, however, not by deregulating the phone industry by redefining their services so that they have minimal obligations in the public interest, but to spur on digital technologies and competition.

Congress enacted the Telecommunications Act of 1996. That Act broke down historic barriers to competition and was designed to unleash a digital free-for-all across all market sectors and industries.

Central to the Act was the notion that we would treat entities based on the services that they were providing rather than based on their pedigree as a cable company or phone company or on the particular type of facilities used to deliver the service. The law, therefore, is intended to treat cable modem and DSL services similarly.

Clearly, Congress built much of the Act and its structure upon the definitions of telecommunications services and telecommunications carriers. To believe, therefore, that when we achieve the digital convergence and deployment of such services to the American people that we also meant to obviate a phone company's or cable company's obligations to law enforcement, interconnection, equal access, universal service or consumer privacy is mistaken. Simply put, it could not have been what Congress intended, because no one would have voted for that.

We must remember that when this subcommittee worked in the 1990's to get the phone industry and the cable industry to deploy digital services to consumers we did so not for the sake of such deployment itself. We did so for the widespread benefits of harnessing the best of the digital revolution, for the entrepreneurs and the businesses at the end of the line, for those that would innovate and contribute to economic growth and job creation.

There may be better ways to achieve the type of broadband competition that drives deployment and consumer affordability, and we may hear some new ideas today that the subcommittee could pursue. The latitude, however, that the Commission has afforded itself to redefine the very services we sought to promote in the Telecommunications Act puts in jeopardy not only many current provisions of law, it also undermines our ability to legislate effectively in the future, especially if the words and terms we use to describe the rights and obligations of unregulated entities may be subsequently swapped for others by regulatory fiat and in headlong pursuit of obtaining a level of deregulation that Congress itself did not endorse.

Again, I commend the chairman for calling this hearing; and I look forward to hearing from our witnesses.

Mr. UPTON. Thank you, Mr. Markey.

I will recognize the chairman of the full committee, Mr. Tauzin.

Chairman TAUZIN. Thank you, Chairman Upton.

Let me congratulate and offer my welcome to all of the witnesses who are here today. It seems whenever we have a telecom hearing we have more witnesses requesting attendance than we have space in the committee. Today is no exception. And I want you all to know that while we hold you all in very deep and personal affection and equal respect, that we hold Mr. Tauke in greater equal respect and admiration, simply because he has served with us and we have developed over the years such an admiration of him. Mr. Tauke and I, in fact, from different sides of the aisle, then led the effort together to begin deregulating free speech in America, and in essence we are still on that track.

What we are talking about today again is an area of free speech in a new form, and every time we talk about the capacity or the power of the Federal Government and local governments to regulate the manner which Americans speak to one another in whatever new form they find, I generally fall on the side of less regulation rather than more, not just to incentivize the new entrants into the marketplace but because I think our Founding Fathers meant for us to fall on that side wherever possible. Because when it comes to the speech of Americans, however they wish to speak, whether it is over a telephone or over an Internet line or a broadband facility provided by a telephone company or a cable company, we ought to, as much as we can, facilitate that freedom.

That is why the Founding Fathers meant and wrote so carefully a first amendment to our U.S. Constitution. It was not designed to protect citizens from one another. It was designed to protect citizens from a government that might regulate the way in which they speak and what they might say and how they might be heard or viewed throughout the generations.

So we start from that principle, and the chairman and Mr. Markey have outlined to some degree the technicality of today's hearing, and while it bears repeating, this is a technical hearing to some degree, because it is government-speak. It is government-speak as to whether or not this new digital world is really information or telecommunications.

Let me first say that I think Chairman Powell has done us all a service by making the right decision when he decided on the underlying question here, that broadband facilities should not have to be provided on an unbundled basis. That was right. It is a good decision.

I only wish we could see it all. I don't know why it is taking so long. It is incomprehensible. Maybe that is why they call it a Triennial Review, because it is going to take 3 years to roll out the decision. But it is time for us to see that decision and begin to see the effects of it.

Now, as you know, the Commission is also getting into the question of what are the services; and the fact that they have decided these are not telecommunication services is a good start. But the underlying transmission component of broadband services is also at stake here, and if you decide that that underlying transmission is going to be subjected to the same sort of regulations by which telephone traffic was formally regulated, then I think we can get into some deep trouble here.

So we are all interested in knowing, both from a State and Federal standpoint, as to how we can advance the cause of freedom of speech here, at the same time advance the deployment of broadband services so that Americans can as freely and as unfettered as possible engage in all the new forms of communication that the digital broadband world might offer them.

So with all the technical speak we are going to hear today, I hope we remember what it is all about. It is all about whether we are going to continue these old forms of regulation that were designed in a day and age of analog transmission when your pedigree did matter because you were different then. As we move into an age when it is all the same, it is all digital broadband transmission of

data that could be voice, could be pictures, could be information or could be entertainment, could be technical, could be medical help, could be educational services, who knows; and as we enter that new world can we enter it with the first amendment in mind, or do we have to just regulate it to death?

I particularly want to welcome Commissioner Davidson of Florida, because you present a refreshing perspective from State commissions. You basically start with the notion, as I do, that it would be awfully good not to regulate it to death. Too much of our State commissioners believe that they have got to regulate everything that walks or crawls or if it threatens to walk or crawl they are going to regulate it. I appreciate your fresh approach.

As Mr. Markey said, I hope we get some good new ideas today. Through all the technical discussions, all that technical FCC and PUCA rigmarole, if we can just all agree that in a broadband world it is all the same and Americans ought to have access to it as unfettered as we can make it available to them.

I yield back. Thank you, Mr. Chairman.

Mr. UPTON. Thank you.

Recognize the ranking member of the full committee, the gentleman from the great State of Michigan, Mr. Dingell.

Mr. DINGELL. Mr. Chairman, I thank you, and I commend you for holding this hearing on the regulatory status of broadband.

I particularly want to welcome our panel. It is a distinguished one, and thank you gentlemen and ladies for being with us today. We appreciate your presence and your assistance.

I want to particularly welcome Commissioner Nelson from the Michigan Public Service Commission; our old friend Mr. Tauke, who I hope is feeling well and doing well, we miss you here on the committee; and also Mr. Sachs; and to the rest of the panel members, my welcome and my appreciation to each of you, too.

Mr. Chairman, this is a timely hearing. It has been more than 7 years since we passed the legislation which came to be known as the Telecommunications Act of 1996. With that Act, it was the intention and the hope of this committee and the Congress that we would see competition enter into the telecommunications business. People would be able to enter it. There would be few regulatory barriers to the entry or to the conduct of the business so that we might see a situation, in the mind of the Congress, where consumers would have options of many kinds of services where entry would be easy, where competition would be brisk and vigorous and where we would remove what the Congress found to be essentially the dead hand of regulation.

We find that we were mistaken. We find that that statute has been much disregarded by the regulatory agencies, particularly the FCC. In fact, there is a publication by a former FCC employee in which he virtually told us how the FCC had reinterpreted the statute, much in defiance of the wishes of the Congress and the committee. We have, from time to time, had members of the Commission up here to discuss these matters and to inquire of them how they could interpret the statute in the curious way in which they have, but we find ourselves now confronted with a rather remarkable series of roadblocks in which the Justice Department and the

FCC are able to find new and unique mechanisms for denying the public the benefits of the congressionally mandated deregulation.

The telecommunications industry continues to suffer, as does the economy in general. Likewise, consumers of telecommunications services continue to suffer and have the lack of availability of high-speed service.

Other countries do splendidly. The United States does not. This is not a coincidence. Telecommunications is a large part of the national economy, and it played a central role in the boom which existed until just a few years ago. As I have said before and will say again, revitalizing this industry can do a lot to improve the fiscal health of this Nation. Promoting broadband development, I believe, is the key to helping this ailing sector, and one way to promote such development is to eliminate roadblocks of a regulatory character which are constantly being placed in the way of that industry by the FCC, the Department and occasionally by State agencies.

Those companies that have weathered the storm so far have had no choice but to reduce capital budgets. Investments in capital expenditures have plummeted, as have company valuations and the stock market, too. The corporate and economic consequences are grave, but the personal consequences in terms of lost jobs and lost retirement savings are even more profound.

The largest of the telecommunications failures, that of MCI WorldCom, was a result of egregious fiscal malfeasance, or perhaps worse; but regulatory mismanagement must accept its fair share of blame for the industry's current state. Applying old rules to new broadband facilities discourages investment, and I find myself constantly trying to understand why it is that different offerers of service in this precise area, substitutable exactly in kind one for another, are treated so differently.

We need to end such regulatory nonsense as we try to transition from narrowband to broadband technologies. DSL has its limits as it rides over the old copper network. Next-generation services and applications, those that will offer broadband, including Internet, voice and video services, will require significant upgrades of current copper-based networks.

We in Congress and those currently at the FCC have an obligation to adopt smart policies so that the marketplace can fund investment and reward those companies willing to risk capital and permit them to do so. We have a responsibility to our constituents who can benefit from the next-generation broadband services and applications and who often have suffered lost jobs and savings.

We must start by freeing new broadband investment from inappropriate regulation such as that curious TELRIC pricing device. We must also create a regulatory regime that does not favor one technology or provider but instead creates parity and opportunity for the smart, the vigorous, the capable and the hard working.

Other opportunities lie ahead, however. We must await the full text of the FCC's long overdue Triennial Review. By all accounts the decision appears to have made some progress, at least with respect to broadband. Having been disappointed many times, I have some curiosity as to whether this is, in fact, so—but from what I am told, if it is finally released someday, if that day comes, it will

adopt much of what this committee tried to achieve in the Tauzin-Dingell bill by ending outmoded regulation of new fiber networks.

I fear, however, that it does little to rationalize the FCC's destructive pricing rules. My understanding is that it preserves the so-called TELRIC methodology with only slight modifications. Such a heavily and artificially discounted pricing mechanism only skews incentives. It robs the incumbents not only of a reasonable return but also of valuable resources they could use to build out robust broadband facilities.

To add insult to injury, it pads the coffers of those who merely sit on the sidelines, doing nothing to improve the telecommunications infrastructure or increase its reach. The FCC should provide for sensible rates to be sure these rates will be wholesale, but they should reflect at least some resemblance of a fair market price.

Further FCC decisions on the regulatory treatment of cable and wire-line broadband services are around the corner. The FCC has already ruled that the cable broadband falls under Title I rather than Title II.

Absent another Triennial Review-type delay, we will soon learn how the FCC will regulate a telephone company's provision of DSL. My position on this matter is clear. If cable broadband deserves Title I treatment, so does wire-line broadband. We will see if the FCC can rise to the occasion. It has disappointed us many times and in serious fashion. If it does not rise to the occasion, then the Congress must.

I look for today's witnesses to give us suggestions on how we can do so. Thank you, Mr. Chairman, and thank you, members of the panel.

Mr. UPTON. Thank you.

Mr. Shimkus.

Mr. SHIMKUS. Thank you, Mr. Chairman. I will just defer my opening statement.

Mr. UPTON. Mr. Wynn defers.

[Additional statements submitted for the record follow:]

PREPARED STATEMENT OF HON. BARBARA CUBIN, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF WYOMING

Thank you, Mr. Chairman.

I would like to thank you for holding this hearing to address an important component of life in the Twenty-First Century. Affordable, reliable and rapid access to the Internet is integral to the evolution of this new, modern means of communication. It also affects how well it can be integrated into our daily lives. Those of us who have broadband connections at work and a dial-up, or narrowband, connection at home know firsthand how a slow connection can impede modern and sophisticated Internet services. That's why properly incenting broadband deployment is a worthy goal for Congress.

Often, however, properly incenting means simply doing no harm. The federal government ought not be in the business of picking winners and losers, so a uniform and non-discriminatory regulatory environment ought to be the policy of this Congress, the Commission and those who seek to apply anti-growth regulations across the nation. That is not to say, however, we need to apply more regulations to more industries just to achieve uniformity—honestly we need less regulation, and I am pleased that it appears this is the direction the Commission is headed. Additionally, if there is an asymmetrical treatment of technologies, it will present troubles in the future as to how classify new and emerging technologies by trying to apply the present scheme.

Of course my overarching concern on broadband is the treatment of rural areas. The more barriers we erect the less likely it is for a company to put capital on the line only to end up bankrupt. There are already impediments that exist all over rural America—and in my state of Wyoming—that discourage broadband service. There are costs that a service provider has to bear in Wyoming that are relatively tiny in more dense population centers. You find miles and miles of roads and acres of majestic beauty in Wyoming. But with a population of around half a million, there is no density to make laying all of those lines and cables profitable.

We do, however, have federal programs that provide assistance to encourage broadband deployment and I also note that they do not discriminate against any specific technology. I think that's a good model to serve consumers and I will continue seeking solutions to encourage broadband service to high-cost rural areas.

I thank our witnesses for coming today and I look forward to hearing their comments on this matter and thoughts about where we go from here.

PREPARED STATEMENT OF HON. VITO FOSSELLA, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF NEW YORK

Mr. Chairman, I'd like to thank you for convening this hearing today. Our Subcommittee has a history of involvement in the development of broadband policy, and our hearing today provides a tangible reminder of our commitment to accelerating broadband deployment.

Many of my colleagues will remember our efforts to enact the Tauzin-Dingell bill in the last Congress. While we were successful in getting that bill passed in the House, unfortunately our counterpart was not able to take up similar legislation. Had we been successful, this hearing might have been very different.

Mr. Tauke states in his testimony that Wall Street is skeptical of increased capital spending and rather has been rewarding cutbacks in investments. He goes on to say that investors believe the regulatory rules make it nearly impossible to realize any return from investments in new technologies. Even though most of my colleagues would agree that telecommunications has changed significantly since the 1996 Act, we still have some people in the decision making process ignoring what the experts are saying and basing their decision on detrimental regulations put in place during an entirely different era of the telecommunications industry.

The FCC had the opportunity to address these issues in its "Triennial Review" proceeding that was concluded earlier this year. While we've all seen the press reports describing the Commission's actions, the text of its decision has not yet been released. I hope that when the Commission's report is released, that those of us who favor the rapid rollout of broadband will be pleased.

I look forward to hearing our testimony here this morning, and yield back the balance of my time.

Mr. UPTON. Well, we are delighted with the panel that we have assembled this afternoon. We will lead off with Dr. Robert Pepper, Chief of Policy Development, Office of Strategic Planning and Policy Analysis at the FCC; followed by Michigan Public Service Commissioner Robert Nelson; Mr. Charles Davidson, Commissioner of the Florida Public Service Commission; Mr. Tom Tauke, our former colleague and now Senior Vice President of Verizon; Mr. Thomas Jones from Willkie Farr & Gallagher; Mr. Robert Sachs, President and Chief Executive Officer of the National Cable and Telecommunications Association; Mr. David Baker, Vice President of Law and Public Policy at EarthLink; Ms. Debbie Goldman, Policy Committee Chair of the Alliance for Public Technology; and Mr. Paul Misener, Vice President of Global Public Policy for Amazon.com.

Dr. Pepper, we will start with you. We appreciate your testimony. All of you that submitted it in advance will try to limit your remarks to 5 minutes.

Dr. Pepper.

STATEMENTS OF ROBERT PEPPER, CHIEF, POLICY DEVELOPMENT, OFFICE OF STRATEGIC PLANNING AND POLICY ANALYSIS, FEDERAL COMMUNICATIONS COMMISSION; ROBERT B. NELSON, COMMISSIONER, MICHIGAN PUBLIC SERVICE COMMISSION, CHAIRMAN, COMMITTEE ON TELECOMMUNICATIONS, NATIONAL ASSOCIATION OF REGULATORY UTILITY COMMISSIONERS; CHARLES M. DAVIDSON, COMMISSIONER, FLORIDA PUBLIC SERVICE COMMISSION; THOMAS J. TAUKE, SENIOR VICE PRESIDENT, GOVERNMENT RELATIONS, VERIZON COMMUNICATIONS, INC.; THOMAS JONES, WILLKIE FARR & GALLAGHER; ROBERT SACHS, PRESIDENT AND CHIEF EXECUTIVE OFFICER, NATIONAL CABLE AND TELECOMMUNICATIONS ASSOCIATION; DAVID BAKER, VICE PRESIDENT, LAW AND PUBLIC POLICY, EARTHLINK, INC.; DEBBIE GOLDMAN, POLICY COMMITTEE CHAIRWOMAN, ALLIANCE FOR PUBLIC TECHNOLOGY; AND PAUL MISENER, VICE PRESIDENT FOR GLOBAL PUBLIC POLICY, AMAZON.COM

Mr. PEPPER. Good afternoon, Mr. Chairman, Ranking Member Markey, distinguished members of the subcommittee. It is my pleasure to come before you today on behalf of the FCC to discuss broadband policy. There are three essential points I would like to make.

First, we believe that widespread broadband deployment will bring valuable new services to consumers, stimulate economic activity, improve national productivity and advance economic, educational and social opportunities for the American public. Second, the Commission has taken a number of actions to foster investment and innovation in competitive broadband platforms. And, third, we are beginning to see the positive results of our actions.

The Commission's broadband policy is guided by several principles and goals.

First, it is the Commission's primary goal to encourage the ubiquitous availability of broadband to all Americans. Creating incentives for innovation and investment in the broadband digital migration stands as a companion alongside our commitment to traditional universal service goals. Second, the Commission is committed to promoting competition across all platforms for broadband services. Third, the Commission's broadband policy is designed to promote investment and innovation in a competitive market by ensuring the broadband services exist in a minimally regulated environment. And, fourth, the Commission is striving to develop an analytical framework that is consistent to the extent possible across multiple platforms.

Over the past 2 years the Commission has taken a number of important steps to implement its broadband policy. The Commission has authorized new broadband technologies. For example, the Commission has opened the proceeding evaluating using existing electric power lines to provide Internet and broadband services. It has also initiated a number of spectrum-related proceedings geared toward broadband, including a proceeding to encourage more efficient use of the 2.5 gigahertz band, authorizing ultrawideband technologies, clearing the way for advanced wireless data networks, also known as 3G services, and more recently the Commission initi-

ated proceedings to provide more unlicensed spectrum and band such as the 5.8 gigahertz band.

In addition to authorizing these new technologies, the Commission also has revisited certain rules and proposed to modify others in order to reduce regulatory costs and uncertainty.

In its cable modem declaratory ruling, the Commission determined the cable modem service is appropriately classified as Title I interstate information service and thus is not subject to Title II traditional common carrier regulation.

In a companion notice of proposed rulemaking, the Commission sought comment on the implications of this finding, and that proceeding is still pending.

The Commission also has a proceeding on broadband over telephone networks and in a notice of proposed rulemaking tentatively concluded that wire-line broadband Internet access is also an information service. The Commission has requested comment on this tentative conclusion and its implications; and this proceeding also, Mr. Chairman, is pending.

As you have noted, the Commission's decision in its Triennial Review proceeding, although not yet released, is important for creating incentives to invest in new-generation networks for broadband services. The Commission's press release at the time of adoption was absolutely clear that fiber-to-the-home loops would not have to be unbundled.

The Commission's broadband policies are beginning to have real results. According to the most recent data available, nearly 20 percent of U.S. households subscribe to a broadband service, and this represents about 30 percent of Internet households. A little less than two-thirds of these subscribers use cable modem service, and the vast majority of the remaining households subscribe to DSL. And according to FCC year-end 2002 data, the number of ZIP codes with at least one broadband provider serving at least one broadband customer grew from 81 percent to 88 percent. These ZIP codes include 99 percent of the U.S. population.

Recent developments also indicate that competition is heating up with consumers as the beneficiaries.

First, the recent announcement by major phone companies that they are coalescing around a single fiber-to-the-home standard is an indication that they are putting new emphasis on lowering costs in order to deploy fiber faster. Second, several of the largest phone companies have lowered their DSL retail prices by more than 40 percent in an effort to stimulate demand and gain market share in cable operators. And, third, new wireless ISPs are emerging that use unlicensed devices to provide Wi-Fi-based broadband.

In conclusion, while first-generation broadband deployment and adoption has been successful, in large portions of the U.S. our job is not done. Not everyone has access to even one, let alone multiple, broadband providers.

In addition, while the experience with first-generation broadband indicates a substantial appetite for broadband, today's networks will not support future broadband and bandwidth-hungry applications. Therefore, the Commission is pursuing actions and policies that create incentives for new innovation and new investment in

competing advanced broadband platforms that will benefit all Americans.

Thank you very much.

[The prepared statement of Robert Pepper follows:]

PREPARED STATEMENT OF ROBERT PEPPER, CHIEF, POLICY DEVELOPMENT, FEDERAL COMMUNICATIONS COMMISSION

Good afternoon, Mr. Chairman, Ranking Member Markey and distinguished Members of the Subcommittee. It is my pleasure to come before you today on behalf of the Federal Communications Commission to discuss broadband policy. There are three essential points that I would like to make.

First, we believe that widespread broadband deployment will bring valuable new services to consumers, stimulate economic activity, improve national productivity, and advance economic, educational and social opportunities for the American public. Recognizing this, Chairman Powell has noted that the development and deployment of broadband infrastructure is the central communications policy of the day.

Second, the Commission has taken a number of actions to foster investment and innovation in competitive broadband platforms.

Third, we are beginning to see the positive results from the direction of our broadband policies.

Goals for Broadband Policy

The Commission's broadband policy is guided by several principles and policy goals. First, it is the Commission's primary policy goal to encourage the ubiquitous availability of broadband to all Americans. Indeed, Congress has explicitly charged the Commission to "encourage the deployment on a reasonable and timely basis" of broadband capabilities to "all Americans." In addition, Congress has expressly stated that it is the policy of United States to "promote the continued development of the Internet and other interactive computer services and other interactive media."

Second, the Commission is committed to promoting competition across all platforms for broadband services. The Commission's regulatory framework conceptualizes broadband to include any and all platforms capable of combining the power of communications and computing to carry bandwidth hungry applications and offer access to the Internet. The migration to broadband is occurring across multiple electronic platforms including traditional telephone, cable, and mobile wireless providers, as well as those developing new technological architectures using unlicensed wireless devices such as WiFi, digital television and even electric power lines. Broadband is based upon a digital migration from traditional technical/industry/legal silos in which the platform on which a communications traveled was integrated with and optimized for a specific service such as voice or video. In the future broadband world, any of the competitive broadband platforms can support any of these services and emerging broadband applications—no platform will be tied to a particular service or application.

The third goal of the Commission's broadband policy is to promote investment and innovation in a competitive market by ensuring that broadband services exist in a minimal regulatory environment. We recognize that substantial investment is required to build out the networks that will support future broadband capabilities and applications. Therefore, our policy and regulatory framework is designed to foster investment and innovation by limiting regulatory uncertainty and unnecessary or unduly burdensome regulatory costs. The need for regulation greatly diminishes as the new and multiple platforms described above develop. At the same time, however, the Commission remains alert and ready to act against anticompetitive behavior by industry players that result in consumer harm. Regardless of the paradigm, the Commission will remain vigilant in monitoring for such behavior.

Fourth, the Commission is striving to develop an analytical framework that is consistent, to the extent possible, across multiple platforms. As service providers reengineer their systems to provide broadband services, we recognize that because these legacy networks have historically been regulated differently, the migration to digital broadband platforms may raise different questions for different platforms. Stemming from these differing legacies, a consistent analytical framework may or may not lead to identical regulatory models across all platforms. It is entirely plausible that legal, market, or technological distinctions may require different regulatory requirements between platforms, or between certain types of providers of one particular platform. At the same time, there are overarching policy objectives that are similar regardless of platform and should be harmonized to the greatest extent possible.

The technological changes driving the broadband digital migration are unrelenting. With this approach the Commission's aim is to ensure that this migration serves the public interest and that all Americans can benefit from advanced services. Universal service has been very successful in bringing telephone service to Americans, including dial-up Internet service. The Commission remains committed to promoting the enormous value of universal service. Creating incentives for innovation and investment in the broadband digital migration stands as a companion alongside our traditional universal service goals.

Implementing the Policy

Over the past two years, the Commission has taken a number of important steps to implement its broadband policy, focusing particularly on creating incentives for the development and deployment of multiple new facilities-based broadband platforms and services. The first group of proceedings focus on authorizing new, potential broadband technologies/platforms while the second group of actions fashion better incentives for additional investment in broadband platforms by reducing unnecessary regulatory costs.

Among the Commission's actions authorizing new technologies/platforms are efforts to reform spectrum policy and to authorize new power line and wireless communications networks.

• *Broadband Over Power Line Notice of Inquiry (NOI).* The Commission is seeking comment to evaluate the current state of using existing electrical power lines to provide Internet and broadband services to homes and offices and to evaluate whether rule changes may be plausible to facilitate the deployment of this technology.

• *MMDS/ITFS.* The Commission initiated a proceeding to facilitate the provision of fixed and mobile broadband access and other advanced wireless services by encouraging more efficient use of the 2500-2690 MHz bands.

• *Spectrum Policy Task Force/Secondary Markets.* The Commission completed first phase of its "Secondary Markets" proceeding, which will provide more flexibility for non-licensee broadband providers to lease spectrum for last-mile connections to homes and businesses, as well as backhaul connections to fiber/broadband networks.

• *Ultrawideband.* The Commission modified Part 15 rules to permit marketing and operation of certain types of new products incorporating ultrawideband technology, including short-range, high-speed data transmissions such as high-speed home and business networking devices.

• *3G/Advanced Wireless Services.* The pending allocation and service rule proceedings will clear the way for auctions (involving, in part, former government spectrum) to provide significant opportunities for high-speed wireless data communications.

• *Additional Unlicensed Spectrum.* The Commission has initiated proceedings to provide more spectrum for the use of unlicensed devices in bands such as the 5.8 GHz band for WiFi, as well as using new and innovative concepts such as "spectrum easements" to enable operation of low-powered unlicensed devices in unused portions of the spectrum.

The Commission also has reformed certain rules and proposed to modify others in order to reduce regulatory costs and uncertainty to investment in new broadband networks and services. These decisions include:

• *Cable Modem Declaratory Ruling and Notice of Proposed Rulemaking (NPRM).* In March of last year, The Commission determined that cable modem service is appropriately classified as a Title I interstate information service under the Communications Act, and does not include a separate offering of a telecommunications service, and therefore, is not subject to Title II common carrier regulation. Historically, the Commission has refrained from regulating services it has classified as interstate "enhanced" or information services. In a companion NPRM, the Commission sought comment on the regulatory implications of this determination and sought comment on (1) legal and policy reasons that might justify different regulatory treatment of cable modem and wireline broadband Internet access services; (2) any constitutional limitations to the Commission's authority to regulate these services; (3) on whether it is appropriate to require multiple ISP access; and (4) the scope of state and local authority to regulate cable modem service.

• *Wireline Broadband NPRM.* In February of last year, the Commission tentatively concluded that wireline broadband Internet access service—whether provided over a third party's facilities or self-provisioned facilities, is an "information service." It also tentatively concluded that, when a provider is self-providing the transmission component of wireline broadband Internet access, this transmission component is properly classified under the Act as "telecommunications," as opposed to a "telecommunications service." The Commission requested comment on this ten-

tative conclusion and whether the Commission's Computer Inquiry requirements be maintained, modified or eliminated and whether important national security, network reliability, and consumer protection obligations should apply to providers of wireline broadband Internet access services.

• *Dominance/Non-Dominance NPRM.* The Commission is seeking comment on what regulatory changes, if any, should apply to the provision of wireline broadband telecommunications services, including whether dominant carrier safeguards should govern incumbent LEC provision of such service, based on an assessment of incumbents' market power in any relevant product or geographic market.

• *Triennial Review of Unbundled Network Elements Order.* Although the final Order has not yet been released, the Commission's press release at the time of adoption was clear that a key component of that decision provides substantial broadband unbundling relief, particularly the determination that fiber-to-the-home loops would not have to be unbundled.

Broadband Deployment

The Commission's broadband policies are beginning to have results in the marketplace. According to the most recent data available, as of the end of March this year, nearly 20 percent of U.S. households subscribed to a broadband service which represents about 30 percent of Internet households. A little less than ⅔ of these broadband subscribers use cable modem service while the remaining ⅓ subscribe to a digital subscriber line ("DSL") service. The number of zipcodes with at least one broadband provider grew from 81 percent to 88 percent (representing 99% of the population) in 2002.

A recent Nielsen/Net Ratings Report found that broadband's acceptance is growing dramatically. The report states that nearly 40 million people use broadband connections, 49 percent more than a year ago. The fastest growing group of broadband subscribers are seniors over 65, increasing 64 percent over the last year, and broadband use by students grew by 51 percent in the same period.

Although these levels of broadband adoption indicate a strong appetite for broadband service, they also indicate a need to foster broadband deployment to those households that have either no or limited broadband service available. In addition, the success of first generation broadband adoption is a clear indicator that there is a need for incentives for investment in the next generation of broadband technologies that will support and stimulate higher capacity services and applications.

Recent developments appear to be strong indications that competition in broadband is heating up with consumers as the ultimate beneficiaries. First, the recent announcement by incumbent local exchange companies ("ILECs") that they are coalescing around a single fiber to the home architecture/standard is an indication that they are putting new emphasis on lowering fiber deployment costs in order to deploy fiber more ubiquitously. Second, while it is too soon to tell how adoption rates will be affected, several of the largest ILECs, including Verizon, have lowered their DSL retail prices by more than 40 percent in an effort to stimulate demand and gain market share on cable operators. And third, new wireless ISPs ("WISPs") are emerging using unlicensed devices to provide WiFi-based broadband service to areas not served by either cable modem or DSL service or only one of the two. In time, these kinds of unlicensed wireless services appear to be emerging as some of the most exciting and potentially viable competitors to existing broadband providers. In addition to providing competition to cable modem and DSL providers, WiFi is proving to be an important broadband driver in another respect. Home WiFi networks are proving to be significant drivers for cable modem and DSL broadband subscriptions.

Conclusion

First generation broadband deployment and adoption has been successful to date in large portions of the United States but the job is not done. Not everyone yet has access to even one, let alone multiple, broadband service providers. Using existing copper network architectures and technology, it's been estimated that DSL will probably not be available to about a fifth of U.S. households. In addition, while the experience with first generation broadband indicates a substantial appetite for high speed Internet access, today's broadband networks will not support the kinds of bandwidth hungry applications now being contemplated by application developers. Therefore, the Commission has undertaken actions and is pursuing policies that create incentives for innovation and new investment in multiple competing advanced broadband platforms that will benefit American consumers.

Thank you.

Mr. UPTON. Thank you.

Mr. Nelson.

STATEMENT OF ROBERT B. NELSON

Mr. NELSON. Thank you, Mr. Chairman. I appreciate the opportunity to address the subcommittee today, and I commend the chairman for calling this hearing on this very important topic.

I represent the National Association of Regulatory Utility Commissioners and also the Michigan Public Service Commission, and it is our belief that now is not the time to undue the framework for regulation of telecommunications services, including wire-line broadband services.

The 1996 Act is bearing fruit, and in Michigan today more than 30 percent of access lines in SBC's Michigan territory are in the hands of competitive providers. This represents about 1 million residential customers. The framework is working. It has been a joint effort of Congress, FCC and the State commissions. The commissions have taken the tools that Congress has given us and have provided for competition, both in voice lines and in broadband.

Indeed, the FCC pricing rules that have been referred to have been upheld by the U.S. Supreme Court, and the court in that action indicated that some asymmetrical regulation was indeed called for because of the monopoly power of the regional Bell operating companies.

While voice competition is increasing in Michigan, unfortunately broadband competition is not. There seems to be a dramatic increase in Michigan and other States, and the market share and competitor providers and indeed the market share of SBC has increased threefold in the last 2 years.

Now, this is important, because I believe that conclusion may jeopardize some efforts that our State has made in recent past. As you know Mr. Chairman, Michigan passed last year some significant broadband legislation. It was recognized last week by Technology Network as the leader in broadband policies throughout the States, both in supply and demand policies. That broadband legislation in Michigan includes financial incentives for all forms of broadband, for providers and users, competitive providers and incumbent providers, but so far none of the grants that have been issued by the broadband authority in Michigan have gone to DSL. That is, in my view, because of the dominance of SBC in the DSL market.

We need to continue to impose the provisions of section 251 and 252 on these providers to allow competition to flourish in that market.

One of the issues that our Michigan legislation addressed was the access to right of way, and in my testimony you will see that we have torn down the barriers of right of way access in Michigan, and this has been recognized by technology networks as one of the key reasons that we are the leader in broadband policies throughout the country.

However, the right of way provisions in Michigan law depend on the definition of Federal law, which is the definition of telecommunications services. If that definition is indeed changed to mean that only information services are provided for right of way

access, it could very well do serious damage to Michigan's broadband policies and the deployment of broadband in Michigan.

Similarly, there are other unintended consequences of characterizing wireline broadband services as information services that is detailed in my testimony, the consequences in terms of universal service, 911, consumer protection, including slamming, entry into rural markets by small providers and, indeed, consequences for voice service as well.

We believe that reclassifying wireline broadband services as an information service will lead to more litigation, and there are ways the FCC can address this issue without so reclassifying this service. They can forebear under the Act and comply with the conditions for forbearance that are spelled out there. They have chosen not to do so.

Now on the eve of the Triennial Review decision, which will bring significant regulatory relief to the regional Bell operating companies, we believe it is not the time to abrogate any vestige of competition in the DSL market. Indeed, 7½ years of litigation under the old framework is just about over. We don't need 7½ years of litigation under the new framework. Let us continue to allow the States to do the job the Congress has given us so that we will spur innovation, lower prices and bring broadband to all providers in Michigan.

Thank you very much, Mr. Chairman.

[The prepared statement of Robert B. Nelson follows:]

PREPARED STATEMENT OF HON. ROBERT B. NELSON, COMMISSIONER, MICHIGAN PUBLIC SERVICE COMMISSION AND CHAIRMAN, NATIONAL ASSOCIATION OF REGULATORY UTILITY COMMISSIONERS' COMMITTEE ON TELECOMMUNICATIONS

Mr. Chairman and members of the Committee, I am Robert B. Nelson, a Commissioner with the Michigan Public Service Commission and the Chairman of the Telecommunications Committee of the National Association of Regulatory Utility Commissioners (NARUC). I would like to thank you for providing me the opportunity to testify today on behalf of NARUC. As many of you know, NARUC, founded in 1889, is recognized in Sections 410(c) and 254 of the Communications Act by this esteemed body as the organization that represents the interests of State Public Service Commissions operating in each of your home States. *Communications Act of 1934, as amended by the Telecommunications Act of 1996,* 47 U.S.C. §151 et seq., Pub.L. No. 101-104, 110 Stat. 56 (1996) (West Supp. 1998) ("1996 Act" or "Act").

Your State commissions, like each of you, have a direct interest in promoting vigorous competition in the intrastate telecommunications market. Each of NARUC's member commissions is responsible for implementing: (1) State telecommunications laws; and (2) federal statutory provisions specifying incumbent local exchange company obligations to interconnect and provide nondiscriminatory access to competitors. See, 47 U.S.C. §252 (1996). Federal law requires the States (and the FCC) to promote advanced telecommunications services like those at issue here. *See,* 47 U.S.C. §706 (1996).

Before turning to NARUC's views on the FCC's current initiative to reclassify all high speed data services as "information services," I want to briefly discuss the negative impact these proceedings could have on Michigan's efforts to promote broadband deployment and economic growth in the telecommunications market throughout the state.

MICHIGAN'S BROADBAND DEPLOYMENT INITIATIVES COULD BE UNDERMINED.

The concept of "regulatory parity" is compelling to policy-makers of all stripes. The FCC is attempting to promote broadband deployment by minimizing the regulation of DSL and other Internet platforms. However, the agency's approach, which is based on an obvious misreading of text of the Act is misguided as a matter of both the law and policy. While I am sympathetic to the overall policy goal of making it easier for providers to invest in innovative technologies and services, I have seri-

ous reservations regarding the FCC's creation of a whole new federal regulatory oversight system by reclassifying services—services that even the FCC, until recently, agreed were stand-alone common carrier service regulated under Title II of the Act—as "information services." I am even more concerned about recent agency action that threatens to eliminate State-imposed line-sharing requirements over the existing network designed to enable multiple providers to offer a choice in voice and broadband services to end-users.

In 1996, Congress authorized the regulatory treatment of bottleneck transmission facilities of the incumbent Local Exchange Carriers (ILECS) as common carrier services under Title II of the Communications Act. It did not leave the FCC to freely reclassify these services at its own discretion. To endorse the FCC's new approach, one must believe that Congress knew nothing about either the Internet or high-speed data services—a notion that ignores the clear text of the 1996 Act and common sense.[1]

High-speed data services/ISDN existed well before 1996, and nothing in the Act suggests these facilities should be exempt from the scope of Title II requirements simply because they employ a broadband technology. Section 251 of the Act makes no distinction between conventional common carrier service and high-speed transmission technologies in defining the obligations of incumbent local exchange carriers.

Moreover, in Section 706, Congress made clear its desire for the States and the FCC to use their regulatory mandate over common carrier services to further the deployment of advanced Internet services. Among the tools identified is "forbearance" under Section 10 of the 1996 Act, which gives the FCC authority to forbear from applying Title II requirements to telecommunications services under specified criteria. The proposal to reclassify broadband transmission service that the FCC itself has, until 2002, consistently classified as common carriage constitutes an impermissible end-run around that section.[2]

As you know, Mr. Chairman, our home State of Michigan has been at the forefront of State broadband policy initiatives, enacting a comprehensive package of bills in 2002[3] that were designed to stimulate the availability of high-speed Internet connections in rural and urban areas of Michigan. These initiatives have resulted in Michigan being rated #1 in both supply-side policies and demand-side policies by Technology Network (TechNet) in its recently released "State broadband Index," which can be found at www.technet.org. Michigan's extensive work in creating a positive environment for broadband investment could be seriously undermined if either Congress or the FCC moves forward to classify wireline broadband services as an "information" service under Title I of the Communications Act. For example, one key component of Michigan's broadband deployment initiative lauded by TechNet, is its dependence on reform of right-of-way access policies. Specifically, the Michigan legislation, among other things, streamlined the process for authorizing access to rights-of-way by providers of telecommunications services, which is defined in much the same way as the 1996 Act defines them. If Section 251(b)(4), which requires local exchange carriers to provide access to rights-of-way by competing providers of *telecommunications services,* is defined to exclude broadband access services, it could undo Michigan's attempt to reform its policies and promote greater broadband deployment.

Nothing under Title I allows the States to exercise any specific authority to ensure open access for ISPs or any other service provider, as is the case under Title II. Even with the authority provided under Title II, Michigan and the surrounding States have still seen an alarming surge in SBC's dominance over the residential DSL market in the last two years. Simply put, Michigan needs the ability to apply the provisions of Sections 251 and 252 of the 1996 Act to require RBOCs to provide nondiscriminatory access to the underlying facilities necessary for competitive, non-dominant providers to provide Internet access services to their customers. Michigan could provide all the financial incentives to spur broadband deployment imaginable but if competitive providers are unable to interconnect with SBC's facilities, the incentives are worthless.

Michigan is not the only State with programs focused on broadband deployment. Several other States like Minnesota, California, Texas and others, have, as a matter of State law, imposed various access requirements on *facilities, e.g.,* "line sharing"—which could face court challenges once the long-awaited Triennial Review decision is released. Many other State initiatives like those in Michigan have targeted programs designed to encourage the deployment of broadband facilities rather than encumber it with additional direct regulation. We believe this is the right path toward invigorating the entire sector.

THE CURRENT FRAMEWORK UNDER TITLE II OF THE COMMUNICATIONS ACT.

Today, ILECS' provide their own DSL service as a stand-alone telecommunications service over their own bottleneck local loop facilities. These services are governed by the Act's Title II (common carrier) regulations that prohibit a carrier from charging unjust and unreasonable rates. At the federal level, such services are also subject to the FCC's *Computer II* and *Computer III* rules, which require the ILECs to provide non-affiliated information service providers (ISPs) with non-discriminatory access to their facilities so that all non-incumbent ISPs can compete with the ILEC ISPs (e.g. Verizon.Net, SBC Yahoo!). The broadband sections of the recently passed *Triennial Review* Order appears to offer significant regulatory relief for the incumbents from access requirements to new facilities and overbuilds of existing facilities.

THE FCC'S APPROACH TO PROMOTING BROADBAND INVESTMENT.

In the FCC's *Broadband Framework* proceeding, the ILECs have urged the FCC to declare that Internet access over DSL is an information service provided via telecommunications, rather than a *telecommunications service.* The ILECs want the FCC to find that DSL Internet access is an integrated information service, subject to Title I, and that there is no common carriage component of the offering that is subject to Title II safeguards.

THE IMPACT OF RECLASSIFYING BROADBAND SERVICES ON VOICE SERVICES.

If the FCC proceeds in making this new paradigm shift in the current rules, the requirement that ILECs provide DSL as a telecommunications service regulated under Title II of the Communications Act, and consequently their obligations under FCC's *Computer II* and *III* rules to provide non-discriminatory access to non-affiliated ISPs, will be eliminated.

Although the scope of the FCC *notice* apparently is limited to "broadband" information services, once the legal principle has been established, it will be difficult to prevent ILECs from offering an "information service," such as voicemail integrated with every voice product, and declaring those voice services (which are virtually always offered to consumers over bottleneck local loop facilities) to be information services that are not subject to common carrier regulation by either the States or the FCC. At best, such questions will have to be litigated.

As voice traffic continues to migrate to the broadband platform, all of the consumer protections attendant to even the most basic common carrier voice service *will no longer automatically apply* if the FCC declares that broadband services are a "deregulated information service" instead of a common carrier service, as it is currently classified. The current common carrier protections under Title II also include the assurance of fair and reliable service at just and reasonable rates; the assurance of just and reasonable terms and conditions of service such as billing and service termination practices; and the assurance of compliance with basic service quality standards. The FCC's reclassification also undercuts additional goals that Congress established to ensure that low-income customers who live in rural high-cost areas, and disabled customers have reasonable and affordable access to the network. See 47 U.S.C. §§254, 255. Congress further sought to ensure that confidential customer information would be safeguarded from disclosure to commercial entities without customer consent. See 47 U.S.C. §258. All of these provisions, however, apply solely to "telecommunications services."

Nothing in the Act demonstrates that all of these public interest safeguards should be left to the FCC, in its sole discretion under its vaguely-defined authority under Title I, to decide unilaterally where and how to regulate essential bottleneck transmission services to further the Act's goals. Nor is it clear how the FCC could simply assert its Title I "ancillary authority" to extend basic consumer protections applicable to Title II services to Title I services.

THE CONSUMER IMPACT MUST BE CONSIDERED CAREFULLY BEFORE GOING FORWARD.

The ILECs have already received substantial unbundling relief for new facilities and overbuilds of existing facilities in the FCC's soon-to-be released *Triennial Review* order. In addition, the FCC's proposed "information services" approach also recently received a chilly reception in the 9th Circuit Court of Appeals. These events suggest that the FCC should proceed with its "information services" initiative with caution—if at all. For either the FCC or Congress to alter the current regulatory structure for broadband and access to telecommunications facilities is a risky undertaking that at best is premature. The FCC is basically proposing, through the use of Title I, a new, undefined, and potentially unlimited paradigm shift in federal au-

thority over ILEC "information services." NARUC is on record opposing the legal rationale the FCC used to justify this action. If the agency chooses to proceed, Congress should urge them to carefully consider the following issues before making any final determinations.

1. Impact on Intra-Platform Competition:

Broadband services are provided over several different technology platforms: wireline broadband Internet access (primarily via xDSL service provided over the legacy telephone infrastructure); wireless broadband Internet access; cable modem broadband Internet access; powerline, and satellite broadband Internet access. All these platforms have different availability and performance characteristics, some of which are substitutes for others and some of which are not. Most consumers live in communities where they receive only one provider per technology platform and some consumers have no choice at all. The FCC's approach may allow specific platform technologies, e.g., cable modem or ILEC DSL facilities, to maintain their dominance over specific facilities in specific geographic areas. Before taking any action, the FCC should seek additional comment on the potential impact its proposed revised regulatory structure may have on intra-platform competition and innovation.

2. Examine The Current Demand for Existing Facilities:

Before moving forward with deregulation, the FCC and Congress should examine the current status of demand-side issues and solutions. In ¶3 of the *Notice,* the FCC suggests that the primary focus of this proceeding is to promote broadband offerings. As Chairman Powell suggested in his October 24, 2001 presentation to the *National Summit on Broadband Deployment,* the existing regulatory structure *may not* be the root cause of the existing penetration problem. In his presentation, Chairman Powell noted: "According to J.P. Morgan, 73% of households have cable modem service available, and 45% of households have access to DSL. Combined broadband availability is estimated to be this year almost 85%. The intriguing statistic is that though this many households have availability, only 12% of these households have chosen to subscribe."

Although the gap between availability and subscriptions is narrowing, it remains substantial. For example, in October of last year, the National Cable Association announced that the cable industry finished the third quarter with 10 million broadband subscribers nationwide *out of 75 million U.S. households then passed by broadband-enabled cable networks.* These reports suggest demand and not supply is the primary existing impediment to the expansion of this market. The lack of demand has been identified, but the reasons for that lack of demand have not been fully explored. The United Kingdom's recent experience suggests that one major factor limiting demand may be the way current services are priced.[4] Others have suggested copyright and content issues have negatively affected demand. A more careful examination of what factors affect take rates for broadband Internet access will help the FCC determine when it should act.

3. Impact on State Proceedings to Promote Competition and Broadband investment:

The FCC's new definition of "information services" will significantly enhance the prospect for protracted litigation over "authority" questions at both the State and federal level. Introducing a new and wholly unknown scheme of regulation into the market at this point injects a substantial level of legal and economic uncertainty. Any regulations that the FCC adopts in this area must not preempt the extensive work already done in a number of States, pursuant to Federal law and following FCC guidelines to promote competition. There are many ongoing proceedings/initiatives designed to foster competition and facilitate broadband deployment, (271 proceedings, DSL transport proceedings, comprehensive OSS third-party testing, UNE pricing dockets), that should be concluded before significant changes are made to the existing regulatory paradigm. The *Notice,* at ¶61, explicitly leaves open the possibility that such access would not be subject to provisions of the Act that require unbundled access to competitors. Under that scenario, access to the transmission path by telecommunications competitors is foreclosed. As a result, a significant number of those competitors may lose the ability to compete for the whole package of services demanded by today's telephone consumers.

4. The Impact On State/Federal Universal Service/Protections That Apply Only To Common Carrier Services:

Adding to the difficulty of analyzing the impact and applicability of the FCC proposals, the Notice applies only to "domestic wireline broadband Internet access services," but does not fully define "broadband." *Notice* at footnote 1. Specifically, the *Notice* is not explicit on whether "broadband wireline Internet access" includes all of a customer's communications, such as voice traffic. It describes "broadband" as

an "elusive concept," and reports on two earlier Commission efforts to define similar terms. *Notice* at footnote 2. It does specify that broadband "presently" consists primarily of DSL services, but nowhere addresses explicitly how the FCC will treat voice service associated with such a DSL service. Significantly, nothing in the *Notice* suggests that the FCC anticipates a different regulatory scheme in which only Internet access over DSL is subject to the scheme instigated by the *Notice,* and voice service is subject to some other kind of regulation. The *Notice* itself, in ¶82 raises the specter of problems with universal service, asking "[s]pecifically, if voice traffic over broadband Internet platforms increases and traditional circuit-switched voice traffic decreases, how, if at all, will that impact our ability to support universal service in an equitable and non-discriminatory manner? Will migration lower or raise the cost of providing service? What, if any, will be the impact on the level of high-cost universal service support needed as voice traffic migrates from traditional circuit switched networks to broadband Internet platforms?" *See also* ¶62 where the FCC first notes its expectation that "traditional services [will] migrate to broadband platforms."

These questions raise a myriad of concerns regarding the FCC's perception of regulatory oversight of voice over DSL services. Aside from the possible impact on State and Federal universal service programs raised in the Notice, for customers who communicate (both voice and data) only through an integrated DSL service, the Commission's decision in this proceeding could eliminate many protections now in place under common carriage principles and Title II of the Communications Act.[5] It could also have a substantial impact on State authority over any local/toll voice service integrated with an ILEC "information service."

5. The Impact on Citizen Access to Internet Content:

Customers using a common carrier today have the ability to send and receive lawful information of their own design and choosing. Title II of the Communications Act's prohibition against unreasonable discrimination has historically protected the rights of those citizens to transmit and receive information without change in its form or content. Some citizens today use broadband services and facilities as their chief source of information and news, even to the point of replacing newspapers. Some citizens can get broadband service only through wireline telephone facilities, and others can get broadband service only through cable modem facilities. In such cases, providers of broadband services or facilities have the technical capability to create a "walled garden" or "fenced prairie," designed to attract customers to preferred content while preventing customers from reaching content other than those of the providers' choosing. Certain broadband providers may have an incentive to restrict Internet access to favored news sources or unaffiliated content providers, and if they chose to do so, could significantly limit free speech.

Although the issue of "open access" has been debated largely as a question of fairness among different kinds of broadband providers, the restriction of user access and its effect on informed citizenship is an issue of real significance in a democratic society. Last November, NARUC adopted a resolution which resulted in the Association urging the FCC, in this proceeding, to assure that: (1) all Internet users, including broadband wireline and cable modem users have a right to access to the Internet that is unrestricted as to viewpoint and that is provided without unreasonable discrimination as to lawful choice of content (including software applications) and receive meaningful information regarding the technical limitations of their broadband service; and (2) where a broadband facilities provider furnishes facilities on a nondiscriminatory basis to ISPs, including an affiliated ISP, nothing prohibits the affiliated ISP from promoting or preferring particular content. If broadband access services are classified as "information services," the ability of the FCC to provide such assurances will be non-existent.

WHAT CAN CONGRESS DO TO PROTECT CONSUMERS UNDER THIS SCENARIO?

Congress should encourage the FCC to delay further action until, at a minimum, the 9th Circuit has ruled in the related Cable Modem proceeding. We further suggest that the Agency should watch the aftermath of the *Triennial Review* order to see if the promised explosion in ILEC deployment actually occurs before taking action in its pending proceedings. Congress may also wish to review the success of various State and local initiatives to promote broadband deployment, many of which were dependent on the tools provided them under Title II.

CONCLUSION

Congress, the FCC, and the State commissions have worked in tandem to take significant steps to achieve deregulation of the local exchange carriers and to pro-

mote competition in telecommunications services. These efforts must be continued jointly. Telecommunications and broadband markets are linked. The approach offered by the FCC in its broadband dockets is inconsistent with the Act and will disrupt existing State broadband and competition-related initiatives. The action proposed in those dockets is, at best, premature and at most a misguided approach to a problem that doesn't even exist—lack of investment and growth in broadband subscribership

After seven-and-a-half years since the 1996 Act was passed, competition in the provision of local voice service is a reality in Michigan and other States, thanks to the tools Congress and the FCC have given us. However, the "last mile" facilities are still owned largely by ILECs, who have used this ownership to dominate the DSL market. Now is not the time to remove all semblance of competition in the provision of wireline broadband services.

ENDNOTES

[1] It is clear from the Act's explicit textual references, that Congress was aware of and very interested in broadband deployment issues. It is hard to square the Act's numerous specific provisions addressing both "advanced" and "information" services, with the Notice's implied contention that Congress wants the FCC to assert sweeping and undefined Title I authority over the "internet and other interactive computer services" through what the Notice concedes is a new approach to defining "information service." When Congress wishes to discourage regulatory oversight, it has no difficulty doing so. *See, e.g.,* 47 U.S.C §160, §161, & §274(g)(2). The FCC's view of Congressional intent is inconsistent with (1) the very limited legislative history of the "information service" definition in the Act, (*See, e.g.,* House Conference Report 104-458 (January 31, 1996) at 114—116, where Congress chose not to go with the "Senate definition" which arguably can be read to support the FCC's view, but rather went with the House version.) and (2) the uses of the term "information services" elsewhere in the Act. The Notice's view of "information service" specifically includes what the FCC has already found to be a common carrier "telecommunications service." Other uses of the term "information service" in the Act undercut such an interpretation of Congressional intent. The Act repeatedly uses the term "information service" in a much narrower context, that of a consumer purchase of information that is delivered to the customer through a telecommunications service.

[2] Treatment of an ILEC consolidated DSL-ISP offering, as not including a "telecommunications service" is also inconsistent with the FCC's numerous findings that DSL is a Title II telecommunications service that can be tariffed. See, e.g., GTE Operating Companies Tariff No. 1, 13 F.C.C.R. 22466, 1998 WL 758441 (1998) at ¶16. ("We agree that GTE's DSL Solutions-ADSL service offering is an interstate service that is properly tariffed at the federal level.") A recent FCC report to Congress found that, to the extent certain forms of phonetophone IP telephony are interstate "telecommunications," and to the extent that providers of such services offer such services directly to the public for a fee, those providers would be classified as "telecommunications carriers" and therefore subject to the requirement to contribute to universal service mechanisms." As the FCC acknowledges in ¶15 of the Notice, that report, in suggesting transmission of an information service is separate from the information service itself, also conflicts with the tentative conclusions in the Notice. FederalState Joint Board on Universal Service, CC Docket No. 9645, Report to Congress, 13 FCC Rcd 11501, 11529, ¶57 (rel. Apr. 10, 1998). In the Advanced Services Second Report and Order at ¶17, the FCC observed that Internet Service Providers "...combine a regulated telecommunications service with an enhancement, internet service, and offer the resulting service, and unregulated information service, to the ultimate end user. (emphasis added) See also Id at ¶¶14, 19 (note 41) & 21 all referring to DSL service as "telecommunications services" under the Act). In re Deployment of Wireline Services Offering Advanced Telecommunications Capability, CC Docket No. 98-147 (November 9, 1999), 1999WL 1016447.

[3] In 2002, Michigan passed three laws to stimulate the availability of affordable high-speed Internet connections. Act 48 of the Public Acts of 2002 creates a Telecommunication Rights-of-Way Oversight Authority to help telecommunication providers cut through red tape and get projects done without having to pay excessive fees or endure unnecessary delays. Act 50 provides tax credits to providers that invest in new broadband infrastructure and, upon certification of the MPSC, right-of-way fees paid under the first bill. Act 49 creates the Michigan Broadband Development Authority to help fund rollout of broadband services in underserved areas.

[4] *See, e.g., Playing to Lose in the DSL Pricing Game,* BROADBAND NETWORKING NEWS, Vol. 12, No. 8 (April 9, 2002) ("Even as cable companies eat their lunch, U.S. DSL providers are raising prices looking for a sweet spot where they can make money. Indeed a forthcoming Yankee Group study reportedly calls high prices the greatest factor preventing broadband adoption from hitting the marks predicted a couple years ago. In the U.K. they've suddenly inverted the situation. BT Group's recent move to slash the wholesale prices it charges British ISPs for providing service through its network has thrown the market into a tizzy. BT announced earlier this year that, as of April 1, it would cut wholesale rates by some 40 percent.") *See also*—Emling, Shelley, "Broadband Providers Moving to Tiered Fees", Austin American-Statesman April 11, 2002. "Companies say tiered pricing gives them the chance to attract customers who haven't signed up for broadband because of the price."

[5] See *Notice* at ¶61-63 acknowledging and seeking comment on the potential impact of the new classification scheme on existing consumer protection requirements, including, e.g., 47 U.S.C. §258 protections against "slamming", 47 U.S.C. §214's limitations on the ability of a telecommunications carrier to unilaterally discontinue telecommunications service to customers, 47 C.F.R. §§64.2001-2009 rules restricting carrier use and disclosure of customer proprietary network information derived from the provision of a "telecommunications service" 47 U.S.C. §255's

requires a provider of "telecommunications service" to ensure the service is accessible and usable by individuals with disabilities, if that is readily achievable. 47 U.S.C. §201's obligations applicable to the furnishing of service and charges for "communication service" and §202 restriction preventing "common carriers" from "unreasonably discriminat[ing] with regard to like "communications services."

Mr. UPTON. Thank you.

Mr. Davidson.

STATEMENT OF CHARLES M. DAVIDSON

Mr. DAVIDSON. Thank you, Mr. Chairman, ranking member and honorable members of the committee. Thank you very much for inviting me here today. I would specifically like to thank the Florida delegation represented on this committee for its ongoing consultation with the Florida Commission on utility-related issues. I am testifying here today as an individual commissioner, and the views expressed herein are my own. That is my disclaimer.

Mr. Chairman, as you know, TechNet recently ranked Michigan in the No. 1 spot on broadband issues, but I have to warn you, Florida is very competitive; and under the leadership of our legislature and Governor Bush in trying to promote economic development, we intend to grab that top spot next year.

Mr. UPTON. Sort of like the Gators last January against the Mighty Wolverines.

Mr. TAUKE. No. More like the Bucks, Mr. Chairman.

Mr. DAVIDSON. All right. There you go. Maybe we are ready to move on to Mr. Tauke now. I have no credible comeback.

Allow me to begin by stating that the policy positions in which I believe are shaped by the goals of Congress and by Florida's interest in having a robust, competitive broadband market. I fundamentally believe in a free market economy and that the market ultimately is the best tool we have to stimulate investment, economic growth, innovation and to maximize consumer welfare.

As our political leaders, you also have recognized and instructed that broadband plays a critical role in ensuring the competitive strength of our Nation. I believe that in tough times regulators have to have the courage to embrace change and think beyond the traditional roles of regulating the price, terms and conditions of access to a monopoly market.

Broadband is an emerging market. Candidly, I don't believe that issues of greater consumer choice, lower prices, marketplace innovation and competition are necessarily best addressed by a fixed application of a preexisting regulatory paradigm that is focused on a monopoly market.

Policymakers to be successful must be willing to consider new and different regulatory schemes, and we must be willing to consider not regulating at all, to put ourselves out of a job if that is what it takes. Our focus in this must not be on which industry group will benefit or lose, and that is a hard issue to deal with here, as we are all lobbied day in and day out, but we have to be focused on ensuring that our consumers win and protecting fair rules of competition, rather than competitors will assure that consumers win.

Chairman and honorable members, I am a mass consumer of technology. I have multiple devices, multiple ISPs, digital cameras. I spend so much money. I want more capacity, and I want better

prices, and I trust as a consumer the market to get me there. As this committee has emphasized repeatedly, broadband development and deployment are critically important, to people specifically and to economic well-being generally. Broadband has an immeasurable potential to enhance the lives of our children, our elderly, our sick, our displaced workers; and the benefits are real.

The December, 2002, report of President Bush's Council of Advisors on Science and Technology on building out broadband found, for example, that broadband telemedicine—and it is not even widely adopted yet, but broadband telemedicine can result in a 15 to 20 percent reduction in mortality rates in intensive care units. Those are the goals that we need to be focused on.

Economists and analysts estimate, as the committee has noted, that accelerating the deployment and installation of broadband could generate billions of dollars annually in economic benefits for the country. Experts also agree that that is going to take a lot of investment up front in technology networks and deployment, and the State of the telecom industry makes this task very, very difficult. Capital spending has fallen over 40 percent, and people are out of work. The industry has experienced an increase of some $800 billion in corporate debt, most of which won't be repaid, and a $2 trillion decrease in market valuation. Market valuation for telecommunications equipment manufacturers alone fell $1 trillion in 1 year.

The willingness of telecom companies to invest is critically important in States like Florida. We, like many States, are facing serious budget deficits; and unemployment levels are a concern. If additional regulatory certainty can be had, whether it be the FCC or this committee, then it should be had.

From my vantage as a regulator, a national broadband policy framework, whatever that framework is, that is deregulatory in nature as opposed to a patchwork of State frameworks makes good policy for a variety of reasons.

First, regulation poses investment risk, and 50 regimes pose a lot of investment risk.

Second, a national policy is consistent with the overall intent of the 1996 Act to provide for a pro-competitive, deregulatory national policy framework.

Third, a national policy is consistent with the inherently interstate nature of broadband. It is, in essence, a jurisdictionless, borderless technology; and with FCC rulings on the interstate and information nature of cable modem service and DSL, such a policy is also consistent with the treatment of other interstate regimes such as wireless.

Fourth, a national policy is best suited to reflect the notion that technological parity should result in regulatory parity, a principle that everyone here seems to agree with. To the extent different platforms provide the same service and customers want high-speed connectivity and data transfer, then those platforms should be subject to regulatory parity, again, whatever that parity may be.

Fifth, as President Bush noted at the August, 2002, Waco Economic Forum, the private sector will deploy broadband, but government at all levels should remove hurdles that slow the pace of deployment.

However crafted, the ultimate policy outcome ought to reflect at least two core principles, parity and a trust in markets. On the first point, again, any regime should reflect the basic notion that technological parity should result in regulatory parity. If regulation responds to technological parity with regulatory disparity, that disparity is a hurdle to greater deployment.

Where two products are potential substitutes, competition is simply not sustainable where the substitutable products are subject to asymmetrical regulation, because the market will always, always, always reward the less regulated technology.

Mr. UPTON. Mr. Davidson, you need to finish.

Mr. DAVIDSON. Thank you, Mr. Chairman. I will conclude on that point and be glad to answer any questions you all may have. Thank you.

[The prepared statement of Charles M. Davidson follows:]

PREPARED STATEMENT OF CHARLES M. DAVIDSON, COMMISSIONER, FLORIDA PUBLIC SERVICE COMMISSION

I. INTRODUCTION

Thank you, Mr. Chairman. My name is Charles M. Davidson. I am a Commissioner at the Florida Public Service Commission, the agency with regulatory jurisdiction over Florida's investor-owned telephone, electric, natural gas, water and wastewater utilities, in accordance with Florida law. My comments here today are those of an individual Commissioner. I would like to thank the Committee for inviting me here to testify. I would also like to thank the Florida delegation represented on this Committee for its consultation with the Florida Commission on utility-related issues. Finally, I would like to thank the House for its leadership on the matter before you today.

Chairman Upton, I am sure you are aware that as recently as last Thursday, TechNet, a national network of CEOs and senior executives of leading companies in the fields of IT, biotechnology, venture capital, investment banking, and law, released a state-by-state ranking of broadband deployment policies with Michigan and Florida leading the way. So, Mr. Chairman, I wanted to congratulate the great State of Michigan on that designation, but I have to warn you—Florida is very competitive, and with the continued leadership of Governor Bush and the Florida Legislature on making our state increasingly more conducive to high-tech investment and economic development, we intend to grab the top spot.

II. OVERVIEW OF COMMENTS

The communications market is characterized by competing and rapidly evolving technologies, by new business models and by consumer choice. Experts and analysts are in wide agreement that investment in broadband technologies and networks is vital for the long-term economic strength of the country. They also agree that realizing economic benefits will require billions in additional up-front investments in technology, networks, and deployment. A sagging tech sector, capital scarcity, and a market that is averse to committing capital in an uncertain regulatory climate argue for as rational a regulatory approach as can be had.

The broadband sector is characterized by fairly robust intermodal competition. While cable modem service and DSL dominate the broadband market, overall take rates for other technologies (e.g., fixed wireless, Wi-Fi, satellite) are increasing. Of the competing technologies, DSL is potentially subject to greater regulation than the others. Where there is technological parity confronted with a regulatory disparity (i.e., where substitutable products are subject to asymmetrical regulation), the predicted economic outcomes in the long run include: a competitive advantage for the less burdened product; decreased investment in the more burdened technology; and less consumer choice.

Technological parity should result in regulatory parity. This principle, the intent of the 1996 Act, FCC precedent, and the interstate nature of broadband all argue strongly for a national broadband policy. Within that policy, there will clearly be many opportunities for state to articulate policies designed to attract investment in, and deployment of, broadband infrastructure within their borders.

III. THE COMMUNICATIONS MARKET IN 2003

A. The Traditional Telephony Market

The regulatory regime embodied in the1996 Act and its progeny presupposes that the relevant market is local telephony, and the regulatory approach is fundamentally grounded in a wireline paradigm. In the regulated market, for example, LATA boundaries matter. In the unregulated market, they do not. The regulated telephony regime presupposes that consumer choice is primarily a function of the ILEC vs. CLEC competition; it is not focused on other competitors or other technologies that may be competing with traditional telephony.

B. The Emerging Market

Competing and rapidly evolving technologies, new business models, and consumer choice characterize the communications market of today. Cable, DSL, Wi-Fi, fixed wireless and satellite technologies are competing for market share. Data, not traditional telephony, is the predominantly stronger growth segment. Convergence of content and conduits is resulting in new corporate strategies (e.g., mergers of service providers and content providers, horizontal and vertical integration) and in bundled product offerings to consumers. The result: customers have greater choice between competing platforms and competing applications.

The largest growth segments have been in the less regulated market. For example, the wireless segment has expanded from roughly 38 million users in 1996 to over 136 million subscribers as of December 2002 (and this estimate may be substantially lower than actual results because carriers with under 10,000 subscribers in a state were not required to report). The stable and deregulatory nature of the FCC's wireless policies is credited for much of this growth.

C. The Importance of Broadband

Experts and analysts are in wide agreement that investment in broadband technologies and networks is vital for the long-term economic strength of the country and, in the short run, central to jump start the economy. Florida's economic development—including skills and job training, education and health care services, and the recruitment and retention of businesses—is increasingly linked to an advanced communications infrastructure. The high-tech, IT, and telecom sectors, which drove economic growth for so long, are suffering. Investments are down; capital is scarce. Broadband enabled activities (streaming video, exchanging music, photography) have the potential to spur new rounds of *upstream and downstream* investments and consumer spending—in content, in software and applications, on device makers (MP3 players, digital cameras, multimedia PCs, etc.) and in retail channels. The oft-cited estimate (of economist Robert Crandall who recently appeared before this Committee regarding the health of the telecom sector) is that accelerating the deployment and installation of broadband could generate $500 billion a year in economic benefits for the country. Whether that estimate is too high or too low, consensus exists that realization of this economic outcome will require billions in additional up-front investments in technology, networks, and deployment.

D. A Sagging Tech Economy

In the past 7 years, the industry has moved from a position of capital abundance to a position of capital shortage. Venture capitalists in the United States roughly quintupled their investments in the telecommunications and media, entertainment and Internet sectors from 1996 to 2000. Investments in the telecommunications and related sectors are a fraction of what they were just three years ago.

That the high-tech sector, particularly the telecommunications industry, has been in a lingering slump is an understatement. A June 2003 report by the New Millennium Research Council and the Competitive Enterprise Institute characterized the state of the industry:

- Telecommunications capital spending has fallen over forty percent.
- One-half million jobs have been lost in the IT sector during that time.
- The telecommunications industry has experienced an increase of $800 billion in corporate debt and a two trillion dollar decrease in market valuation.
- Market valuation for telecommunications equipment manufacturers alone fell one trillion dollars in one year.

A July 1, 2003 Wall Street Journal article reports equally dismal statistics for the nation's telecommunications sector:

- Telecom investment is down 75% since 2000.
- There have been more than 1,000 telecom bankruptcies.
- The market has witnessed a nine-year low in venture capital investments.
- There is a 28-year low in initial public offerings.

Still, this and other recent articles appear to indicate a renewed optimism based on substantial growth in broadband subscribership. I too hold out hope for the industry, and if anything can reverse the downward spiral of this ailing sector, it is broadband. That is why it is so critical for regulators such as myself to practice restraint in areas where basic economics dictate that the market provides its own, more efficient policing mechanism. To do otherwise would risk stifling investment and further setbacks to our economy.

E. Companies Face a Critical Paradox

Communications companies face a critical paradox: they must respond to the constant need for innovation and growth while at the same time they must manage profitability and cash flow in very constricted capital markets. A recurring topic is the role that the current regulatory regime has had in creating this paradox. The issue is of obvious, and critical, importance—given the central role that our communications infrastructure plays in the nation's economic development and given that billions of dollars of future investment will be required for broadband to reach its full potential.

The constriction in the capital markets will impact business strategy and *should* impact regulatory policy. Investors increasingly value companies based on available internal cash flow. The constriction of capital markets means that companies that can self-finance projects from internal free cash flow will have a strategic advantage over those companies seeking cash from Wall Street. It also means that companies will invest their cash flow cautiously. As such, it is critically important that regulation not misalign investment incentives by treating similarly situated competitors dissimilarly.

IV. THE REGULATORY DISPARITY INVOLVING BROADBAND

Based on FCC data released in June 2003, cable remains the dominant provider in the broadband market. In December 2002, cable held approximately 57% market share. DSL accounted for 33% of the market. Broadband technologies such as fiber, satellite, fixed wireless, and other wireline services (excluding DSL) roughly accounted for the remaining 10%. With the exception of fiber and other wireline service, these technologies experienced approximately 25% growth over the last half of 2002. From the consumer's vantage, a strong argument exists that DSL and cable and other platforms are substitutes for one another in the delivery of broadband services. Consumers can receive similar services over different platforms and could, if the price of one platform is "too high," switch to another platform.*Of the four major competing broadband-delivery platforms (i.e., cable, DSL, satellite, wireless), DSL is the most regulated platform. Cable firms can package, price, invest in and sell services, including broadband, as they deem appropriate. Economics 101 teaches that where two products are substitutes for one another, competition is not sustainable where the substitutable products are subject to asymmetrical regulation.* In a market characterized by competing, substitutable technologies but also by asymmetric regulation, investors and companies will compare the anticipated ROI of a dollar of capital when it is invested in the regulated sector to a dollar of capital invested in the non- or less-regulated sectors. A rational investor seeking a maximum return on its investment would, all else equal, choose "non-regulated" investments.

The stakes of this debate are high. Competition law is not about protecting competitors or categories of competitors, whether they are cable companies, RBOCs, CLECs, or wireless companies—it is about protecting *competition,* which, in turn, *protects consumers.* With its market share, cable has the greatest potential at present to obtain market power, *i.e.,* the ability to "lock in" customers for its broadband, content services, and pricing. As a substitute for cable broadband and with roughly one-third of the market, DSL is currently the best positioned to compete with cable. The asymmetric regulation of DSL (i.e., treating DSL like traditional telephony), however, will likely deter optimal investments in the development and deployment of a competitive broadband infrastructure. Any regulatory misalignment of capital flows is especially acute in view of the current capital issues faced in the communications market.

V. THE RATIONALE FOR REMEDYING REGULATORY DISPARITIES

A. General Considerations

Economic theory argues for a level playing field—let the competitors compete, and competition will yield optimal results. If the goal is a level playing field, then two basic questions are begged: (i) what is the market, and (ii) who are the competitors? A realistic characterization of the communications marketplace requires that it be considered broader than wireline. Competing platforms can offer relatively com-

parable applications and services. For competing platforms to be able to meaningfully and fairly compete on a level playing field, either the mandates to which DSL may be subjected should be removed, or similar mandates would have to be imposed on cable broadband and other broadband providers.

The 1996 Act, designed to deal with an established market and established networks and regional monopolies, is not well-suited to the development of a competitive, facilities-based broadband market. The Act presents three approaches to competition and, related, three strategies for competing: resale, unbundling, and facilities-based competition. Facilities-based competition is the desired outcome. The resale components of the Act, confining a competitor to deriving revenue between resale and retail rates, is not a viable long-term strategy and would not encourage optimal investment in broadband infrastructure. Unbundling presents more of a mixed, though still problematic, picture in the broadband market. With an unbundling strategy, a competitor does have some latitude to provide differentiated services that combine unbundled elements from the ILEC with elements provided by the competitor. And the unbundling of existing facilities has contributed to the deployment of broadband. For example, through the unbundling of existing local loops, CLECs have provided DSL service in some areas underserved by ILECS, and they may have stimulated greater deployment by ILECs.

Unbundling, as premised in the 1996 Act, connotes an unbundling of existing (static) facilities. Upgrades and improvements to networks are constantly required—especially in the context of broadband development and deployment. Broadband providers would have less of an incentive to invest in upgrades and improvements if they would ultimately be forced to provide access to the broadband network on terms & conditions other than those that are market-based.

While the rules regarding local phone service were appropriate for opening established networks that were built when traditional telephony was *the* market and when that market was dominated by regional monopolies, the rules do not apply well to emerging markets where constant innovation is characteristic—as in the broadband market. Whereas much of the risk in developing the traditional telephony networks was shouldered long ago, in a market where the incumbents had monopoly power, the development and deployment of broadband presents an enormous and immediate financial risk for firms. In contrast to the traditional telephony market, where there has historically been a guaranteed customer base from which a service provider could expect a certain minimum return on its investment, there is no such guaranteed customer base for competitors in the broadband market. *Applying a monopoly-focused regulatory regime to an emerging market characterized by competing technologies and companies may disincent players from investing in broadband.*

VI. CORE ELEMENTS OF A BROADBAND POLICY [1]

A. A National Policy for an Interstate Service

1. The Interstate Nature of Broadband—Based on the nature of the technology and the reality of the market, broadband service should be treated as interstate in nature because broadband is interstate in nature. Broadband technologies and platforms exist and function for the most part without regard to state boundaries and as part of a national (indeed, global) communications infrastructure.[2] This inherently interstate nature of broadband argues strongly for a single, coordinated federal policy (either via legislation or FCC action) that is economically rational and respects markets.

2. The Intent of the 1996 Act—A national broadband policy is fundamentally consistent with (if not required by) the Telecommunications Act of 1996, which was designed "to provide for a *pro-competitive, de-regulatory national policy framework* designed to accelerate rapidly private sector deployment of advanced telecommunications and information technology and services . . ."). *See* H.R. Conf. Rep. No. 104-458, at 1, reprinted in 1996 U.S.C.C.A.N. 10 (emphasis added).

Further, Section 706 of the 1996 Act provides the FCC with the ability to create a minimalist regulatory regime. Indeed, Section 706 imposes upon the FCC the obli-

[1] While I believe that a sound deregulatory approach to broadband will best serve the consumers of Florida (and across the country), my responsibility, as a state Commissioner, is to apply federal and state laws on the books.

[2] Broadband is used almost entirely for Internet service. Internet access is likely to include communication with websites in multiple states (and multiple countries). The substantial majority of communications over the web are interstate on an end-to-end basis. This is the FCC's longstanding and consistent basis for determining the jurisdiction of traffic. Treating the entire broadband medium as interstate in nature reflects that there is no reasonable way to segregate Internet communications into intrastate and interstate communications.

gation 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*" (emphasis added).

3. FCC Precedent—Recognizing broadband to be interstate in nature and an information service[3] is entirely consistent with FCC precedent. In 1998, the FCC determined DSL service to be an interstate service. In 2001, the FCC determined Internet access to be an interstate service. In 2002, the FCC determined cable modem service to be an interstate information service. In its Wireline Broadband NPRM, the FCC tentatively concluded that wireline broadband is an information service. Numerous broadband platforms and information services exist (and new ones will surely emerge).

The need for regulatory consistency and stability argue for determining "broadband" generally to be an interstate information service subject to regulation, if any, pursuant to the FCC's Title I ancillary jurisdiction. If the FCC were inclined to regulate DSL under Title II, then, given DSL's lack of dominance in a competitive broadband sector and based on established law and practice, federal policymakers should consider forbearing from applying Title II access-like obligations on broadband platforms and services. Related, to the extent that Title II obligations are imposed on one platform, such obligations should be applied symmetrically across platforms and should not intentionally or inadvertently pick winners and losers.[4]

4. Regulatory Parity—Any national policy regime should reflect the basic notion that *technological parity should result in regulatory parity.* Whatever Congress or the FCC decide,[5] as the case may be, the ultimate policy should not discriminate based on the underlying technology and platform used for the delivery of broadband. From the vantage of the consumer, there is no reason for regulating non-dominant broadband providers differently. Although via different platforms, consumers seek essentially the same service from broadband providers—namely, high-speed connectivity and data transfer.

Two avenues exist for achieving regulatory parity: "regulating up" or "deregulating down." Because the broadband market is competitive and because consumers have choice, deregulating broadband to the point of regulatory symmetry amongst platforms would likely do more to encourage investment in broadband than would regulating up to the point of symmetry.

5. The Risks of State Regulation—State regulators are, and have historically been, concerned with price (i.e., the price that historic monopolists in local telephony charged consumers and the price at which parts of the monopolist's network were unbundled or resold to competitors). Given the lack of fully competitive local markets, the 1996 Act (and the U.S. Supreme Court's May 2002 decision upholding the FCC's pricing/access rules) instructs regulators to focus on price and the other terms and conditions of access to local markets. As Chairman Powell has cautioned, regulators must "vigilantly guard against the regulatory creep of existing models into broadband, in order to encourage investment."

Absent a national policy, there is a risk that, at least in some states, the existing model for regulating local competition may creep into broadband. Because DSL is an emerging technology housed on a regulated platform (i.e., an incumbent telecommunications network), a real risk exists that regulators may assume that DSL should be dealt with in the same manner as the regulated platform on which it is housed. The risk is that state regulators may seek to regulate the deployment of broadband using the existing telecom laws and may treat broadband networks no differently than local phone networks—by focusing on price and other terms and conditions of broadband. It is respectfully submitted that in our free market economy, regulation must not substitute for what markets do best.

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[3] *Telecommunications Service* means "the offering of telecommunications for a fee directly to the public, or to such classes of users as to be effectively available to the public, regardless of the facilities used." 47 U.S.C. § 153(46). Information Service means "the offering of a capability for generating, acquiring, storing, transforming, processing, retrieving, utilizing, or making available information via telecommunications . . ." 47 U.S.C. § 153(20).

[4] Consideration should be given to allowing DSL providers to opt to provide broadband within Title II, as an argument exists that providing DSL service as common carriage is important to the deployment in rural America.

[5] A blanket FCC policy to treat all broadband services as information services may be argued by some to be a usurpation of Congress' power to legislate. As such, a legislative deregulation of broadband, if that were ultimately the goal of Congress, would provide greater certainty upfront.

The challenge facing state regulators is, thus, to avoid regulation of the advanced technology while simultaneously fulfilling their mandate with regard to the regulated technology. A national policy on the former would help address that challenge.

B. The Roles for the States

As a preliminary matter, regulators should avoid the temptation to cast the issue as one of states' rights versus federal preemption. *State and federal policymakers should be pursuing the same core goal—that being to promote investment in the development and deployment of broadband infrastructure.* Fifty states with potentially fifty different regulatory policies will not further that goal.[6]

The market teaches that one outcome of national broadband policy will be greater regulatory certainty. To the extent that a national, markets-based policy is adopted, as opposed to a patchwork of varying state rules (some of which may be economically rational and some of which may not), greater certainty (i.e., less investment risk) will result. An industry that faces fifty potentially divergent jurisdictional approaches to broadband will have less of an incentive to invest than would an industry that faces a more uniform, deregulatory national policy.[7]

The states clearly have a fundamental role in ensuring that the benefits of broadband are—available to its citizens. States can and should work to remove unnecessary barriers to broadband deployment. In particular, states can work with local governments on rights-of-way access and permitting issues. To address the supply side, states can also create financial and non-financial incentives for build-out of the broadband network. To address the demand side, states can offer e-learning applications and other e-government initiatives to promote the value of using broadband technology to carry out day-to-day functions. If states act quickly to bring broadband to its citizens and to provide valuable services that can be most effectively utilized by broadband technology, those states and the citizens within the states can look forward to reaping the economic rewards that follow investment in broadband infrastructure.

C. The Common Carriage Argument

Opponents of broadband regulatory reform—or proponents of open access—argue that to exempt DSL from regulation would undo key provisions of the 1996 Act and would undermine local phone competition. Critics of reform argue that the system that has worked for local phone competition—i.e., incumbents opening their networks at rates set by the federal government, resulting in more competitors—should be the same system for regulating broadband. In short, because the broadband market is competitive, the open access required in a common carriage regime should not be mandated—though it should certainly be encouraged. To the extent, open access would be required, such access should reflect market-based pricing (and other terms and conditions).

VII. CONCLUSION

Advocates for a national broadband policy argue that the potential for broadband to serve as the engine for (or at least stimulate) the nation's economic growth is not yet being met. Advocates point to a number of justifications: the regulatory disparate treatment of similarly-situated competitors, capital market constriction, sub-optimal state regulatory philosophies, poor demand for broadband and related applications, concerns about copyright infringement, etc.

These concerns argue for reform in a variety of arenas: at the FCC, in Congress, by state regulators and in the private sector. Meaningful change will not occur in one sphere alone. The FCC's classification of DSL as an "interstate information service" rather than a "telecommunications service" would be less significant if broadband providers do not meaningfully address the business challenges con-

[6] The reasoning of states-rights supporter Justice Scalia on the local competition issue supports the notion of a national broadband policy. As Justice Scalia has stated, "[T]he question . . . is not whether the Federal Government has taken the regulation of local competition away from the states. With regard to the matters addressed by the 1996 Act, it unquestionably has. The question is whether the state commissions' participation in the administration of the new federal regime is to be guided by federal agency regulations. If there is any presumption applicable to this question, it should arise from the fact that a federal program administered by 50 independent state agencies is surpassing strange."

[7] The process of reducing the burden of regulation is not an easy one, however. It may take some time for the FCC to remove all of the restrictions that potentially stifle the investment needed to develop a truly vibrant and pervasive national broadband market. Should the FCC lose heart at some stage in that process, it may fall to the states to stay the course and continue efforts to ensure that their citizens get the benefits of a robust market-driven broadband infrastructure.

fronting them—such as getting broadband to the last mile, stimulating demand, dealing with convergence, etc. Congress legislating supply-side development or deployment incentives will have a sub-optimal impact if regulators treat broadband like traditional telephony. Development of a competitive, fully-functioning broadband market poses multi-pronged challenges and calls for a multi-pronged solution by various actors.

My policy positions are based on a fundamental belief that the real beneficiaries of a robust broadband market are the consumers. Those entrusted with making public policy decisions must be relentless in their pursuit of broadband policies that ensure we expeditiously provide consumers with more choices of innovative technologies at the most efficient prices.

Mr. UPTON. Thank you.

Mr. Tauke.

STATEMENT OF THOMAS J. TAUKE

Mr. TAUKE. Thank you, Mr. Chairman and distinguished members of the committee.

I am before you today to tell you that, without changes in regulation, the deployment of high-speed Internet access will be significantly impeded to the detriment of all Americans. That is how I began my testimony in 1999 before this subcommittee. I have testified five times in the subsequent 4 years since then. This is becoming a habit; and, as much as I love all you guys, it is a habit I would like to break.

But at the rate we are going I think the real world on MTV will take place in a geriatric unit before we see a national broadband policy coming out of the FCC, not of course that I have ever seen the real world.

But, in any event, why should you care about a national broadband policy? Well, I have three reasons.

Reason one is it is the economy. The fact is, is that sometimes we are so close to the telecom sector that we forget how important it is to the economy as a whole. Just a few years ago in the year 2000 this wireline, just the wireline sector of this industry, had a capital budget of $104 billion. Now to put that in a little perspective, that is five times the capital budget of the auto industry.

Second, you should note that now, instead of $104 billion, the wireline sector has a capital budget of $42 billion, a drop of some $60 billion, and that is last year's number. This year it will probably be a little lower.

If you look at a company like Verizon, we had a capital budget a couple years ago of $18.5 billion. We haven't dropped as much as the industry as a whole. We are down to $12.5 billion. But that $6 billion reduction in capital investment means a lot of jobs. For every $100 million we spend, we create some say 700, other economists say up to 1,000, but 700 to 1,000 jobs.

So if you take the reduction of $6 billion annually in capital investment that is occurring in our company, that is 45 to 60,000 jobs. But that is only the tip of the iceberg, because for every job in our company created through capital investment, there are four more jobs created in other companies for another 200,000 or so jobs.

Now you can get carried away with this stuff, but if you think a $60 billion drop in capital investment, five jobs created for every thousand dollars or—or 5,000 jobs created for every hundred thousand dollars spent, even if you take the statistics and cut them in

half, it is about 2 million jobs that this has cost this economy as a result of the decline in investment in the wireline sector.

Why have we had this decline in investment in the wireline sector? Because we haven't known what the rules were to make the transition from the old network to the new network; and if you don't know what the rules are, it is hard to make a business case for investment in that new network. So this is important to infrastructure investment, which now is critically important to the economy.

Reason two: Consumers are being denied services, competition and choice. The fact is that uncertain policies stalls deployment, and when deployment is stalled, consumers suffer, because services and applications are not developed and delivered to those consumers.

Reason three: Government policy is unfair, and that is what you do, government policy. It is unfair. It is wrong. It is outdated. We love our friends in the cable industry, but the cable industry has over 65 percent of the consumer broadband market, yet they aren't regulated. We have about 31 percent of that market. Our sector of the industry, we are regulated to beat the band. This isn't right. It is wrong.

So what can be done? Well, first, you need to establish a national policy, a national broadband policy. The country has been waiting for 4 or 5 years for this. And as you do that, bring speed, clarity and decisiveness to this effort.

More specifically, the Triennial Review needs to come out. We need to know what the FCC did so that we can begin to move forward with our plans for deployment. We have been marching forward with the setting of standards. We have been working with our suppliers, but until you know what the rules are, it is pretty hard to finalize the business case or even know what kind of network you are deploying.

Second, we need the proceedings on definitions to be finalized so we know what rules will govern broadband networks and services. Right now, we are under Title II, which is voice telephony. It is complicated regulation. It is arcane regulation. It is costly regulation. Broadband is not traditional voice telephony. We are not a utility in the broadband marketplace. We are not a monopoly in the broadband marketplace. We are a competitor who is trying to fight for market share and deliver new services in this marketplace.

So we believe that the FCC should not apply Title II regulation to us but apply Title I, what the FCC has used in the past for Internet services and the way it is already classified cable broadband.

If the FCC acts, it is going to permit the transition of the wireline industry and the Nation's wireline infrastructure to move forward. We need that transition in the jobs and investment to go with it. It is going to provide a boost to the economy and jobs; and, third, it is going to deliver more services and more choice to consumers.

Thank you, Mr. Chairman.

[The prepared statement of Thomas J. Tauke follows:]

PREPARED STATEMENT OF THOMAS TAUKE, SENIOR VICE PRESIDENT, VERIZON COMMUNICATIONS

Mr. Chairman, thank you for this opportunity to testify before the Committee. I am Tom Tauke, Senior Vice President for Public Policy and External Affairs at Verizon Communications. I am before you today to discuss broadband telecommunications and what the federal government should do to help broadband achieve its full potential. Unless there are changes in the current regulatory regime, the deployment of broadband will be significantly impeded, to the detriment of the American economy as a whole, and to all Americans.

My message today is simple. There is general consensus that broad deployment of broadband is a good thing, that it will benefit the economy and consumers, and that we need a coherent national policy that fosters the deployment of broadband and all the benefits it promises. This deployment will require significant additional investment, and government policy therefore needs to be conducive to that investment.

We believe that the FCC took the first step in that direction in the broadband sections of the Triennial Review order, limiting some of the "old rules" to the "old wires" of traditional telephony. And Verizon has reacted in the marketplace to what it believes that order says. The FCC now needs to finish the job and free the "new wires" from the remaining "old rules" by acting promptly to establish a consistent national policy that does not interfere with industry's deployment of broadband capabilities. If the Commission does that, Verizon and, I believe, others will respond with greater investment in and deployment of broadband.

THE IMPORTANCE OF BROADBAND

Broadband is the capacity to deliver high-speed data communications access with a continuous "always on" connection and the ability to both receive and transmit digital content or services at high speeds. It can provide the stimulus that the economy needs, and transform the way we live, learn, work and play. The high-speed networking of digital devices of all kinds—from PCs to digital health monitoring devices is vital to our economy and the advancement of society.

Mr. Chairman, the Internet is a wonderful tool that developed far faster than anyone imagined. Use of personal computers and dial-up access to the Internet fueled the growth the U.S. and world economy enjoyed in the late 1990's. This growth has reached a plateau. More is needed now to move the economy to the next level. And that stimulus—stimulus to the economy as a whole—could be provided by greater deployment of high-speed, broadband telecommunications. The widespread adoption of broadband will increase the efficiency and productivity of Americans at work and at home—with a potential $500 billion impact on the United States economy[1]. The benefits to the quality of life are immeasurable.

There is broad recognition that as a mainstay of the Internet's development and growth, the telecommunications sector is hurting. Between 2000 and 2002, overall annual investment by wireline telecommunications carriers, including Verizon, declined from $104.8 billion to $42.8 billion, a reduction of over $60 billion in just those two years.[2] Spending on new equipment is down 19% in 2003 from the already depressed levels of 2002,[3] and R&D expenditures have plummeted.[4] Over half a million jobs have been lost in the sector since 2000.[5]

Because of the importance of our sector to the economy overall, this is bad not just for our companies but for the national economy as well. Historically, almost a quarter of GDP growth in the 1990's was the result of investment by IT and telecom companies.[6] Investments by the telecom sector have huge multiplier effects. Each

[1] R. Crandall & C. Jackson, *The $500 Billion Opportunity: The Potential Economic Benefit of Widespread Diffusion of Broadband Internet Access,* Executive Summary, page iii (July 2001).

[2] *Skyline Marketing Group, CapEx Report: 2002 Annual Report, Carrier Data Sheet 1 (June 2003); see also TIA, 2003 Telecommunications Market Review and Forecast at 56, Tables II-4.1 & II-4.2 (2003) (spending by carriers on telecommunications equipment decreased by 26.2 percent in 2001 (from $58B to $43B) and by 49.1 percent in 2002 (from $43B to $22B). Despite cut-backs, Verizon's capital budget that remains among the largest of all companies in America. It spends more than the big three auto companies combined, for example. It employs over 250,000 people in 31states, who maintain and build its networks.*

[3] *A. Latour et al., A Wrong Number for Telecom: Big Operators Cut Spending by 19%, Wall St. J. (Apr. 28, 2003).*

[4] *M. Balhoff, CFA, Legg Mason, Investment and the Public Interest, Presentation at the Institute of Public Utilities Conference, December 10, 2002, page 7 (investment in R&D by Lucent fell 28% from 2001 to 2002 and R&D investment by Nortel fell 39% during the same time period).*

[5] *M. Balhoff, CFA, Legg Mason, Investment and the Public Interest, Presentation at the Institute of Public Utilities Conference, December 10, 2002, page 6.*

[6] *D. Jorgensen, American Economic Report (March 2001).*

dollar invested in telecommunications infrastructure results in almost three dollars in economic output.[7] For every $100 million of capital spending by telecommunications companies, about 700 jobs are created,[8] and spending these capital dollars on broadband means even more job growth. For every job created in building broadband networks, four more jobs are created in related industries.[9]

Broadband deployment will benefit the people of America directly and personally, in addition to the benefits they will receive from a healthier national economy. These benefits go well beyond e-mail, instant messaging and web surfing.

For example, telemedicine over a high-speed network will improve the quality of medical care in remote or rural areas. But broadband will also make receiving medical care less of a burden for patients everywhere by, for example, finally making it unnecessary for the patient to run around from lab to doctor to specialist picking up and delivering copies of her x-rays and test results.

And we all know the power of broadband for entertainment and the promise of video-on-demand and similar services. But broadband will also let parents send home movies of their children to their grandparents across the country, instantly and cheaply.

It is these benefits that make Verizon believe in the future of broadband telecommunications and want to be part of that future.

WHAT ARE THE BARRIERS TO BROADBAND DEPLOYMENT?

Verizon broadband today is primarily DSL services, which provide significant improvements in data transmission speeds. But DSL is only a first step, with the goal being fiber optic deployment into neighborhoods and homes. But as costly as the job is of making DSL capabilities widely available, the task of rewiring the country with fiber makes DSL deployment look like pocket change. Though the investments necessary to make this a reality are massive, Verizon realizes that this is where its future, and the future of the industry, lies.

But very real external forces inhibit what Verizon can do.

First and foremost is regulation—both bad rules and regulatory uncertainty have slowed and continued to slow deployment. When Congress passed the Telecom Act, it thought competition could work for consumers in the telecommunications market. That part was right; but regulators implemented the law by forcing competition through the transfer of revenues from the telephone companies to firms entering the market. This was done primarily by making incumbents sell services to the new firms at below-cost prices, allowing the new entrants to win customers and make profits without paying the true costs of what they bought and without making any investments whatever. With this regulatory scheme, why would any company take the risk of making massive investments to provide broadband services? The FCC appears to understand that this scheme will be a disaster for broadband, but it must issue an order to that effect.

But that's only part of the problem. The FCC has an entire body of additional regulations developed under Title II of the Act for traditional telephone services. Those rules limit telephone companies to recovering the cost of risky new investments that succeed, while forcing them to absorb the cost of any that don't. They impose still another set of unbundling obligations that increase both the cost and risk of investing in new broadband services. And they impose arcane advance approval requirements that delay the roll out of competitive new broadband services that our customers want. Applying these rules to broadband makes no sense, and deters investment.

Given the deep roots of regulation in the telecommunications sector, policy matters a great deal. It sends important signals to investors and creates expectations about the relative merits of investing in new technologies, cutting costs and employing more workers. Wall Street is skeptical of increasing capital spending in telecommunications and instead is now rewarding cutbacks in investment. This skepticism is based, in part, on the normal factors of the competition and the state of the economy. But in the telecommunications industry, a significant factor is investors' belief that the regulatory rules simply make it nearly impossible to realize any return from investments in new technologies and services. We need to reverse these trends for the good of the economy, the industry and consumers.

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[7] *Input-Output Accounts Data: 1999 Annual I-O Table Two Digit at Table IOTotReqIxCSum.xIs, http://www.bea.doc.gov/dn2/I-o.htm#annual.*

[8] *Telnomics Research, 2003, Washington, D.C.*

[9] *M.J. Mandel, "The New Business Cycle," Business Week, March 31, 1997, and S. Pociask, "Building a Nationwide Broadband Network: Speeding Job Growth" New Millennium Research Council (February 15, 2001).*

WHAT'S NEEDED?

What's needed is a new approach that takes account of competitive broadband deployment. The broadband marketplace of today has a number of competing technologies vying for the consumer's attention and wallet. Cable companies, telephone companies, wireless companies, satellite companies and, now, WIFI networks compete aggressively offering broadband services that consumers regard as interchangeable.

Cable companies, free of regulation, are among the most active competitors. They have invested $70 billion in upgrading and digitizing their networks and have the capability of offering hundreds of digital TV channels and broadband services. They are moving to use this same platform to offer voice telecommunications services employing efficient Internet protocols.[10] They are dominant in the broadband market with two-thirds of the households (12 million) that have signed up for broadband to date.[11] And they are not regulated.

Verizon is eager to compete head on with cable and other technologies that are vying for costumer's attention. We are willing to enter these new and unproven markets and to take the risks involved in doing so. But we—Verizon, the industry and the public—need government to do its part to reform current regulations that affirmatively hold back investment.

First, we need a Triennial Review order on broadband that is clear and that cannot be gamed. We need the FCC to finally declare that Broadband technologies will not be subject to the unbundling rules that were devised for a voice network.

Second, we need a sound national policy that permits all infrastructure providers to compete. Cable has over 65 per cent of the high-speed broadband consumer market. Cable's broadband network and services are not regulated. So what is the justification for regulating the broadband network and services of companies that have a market share of less than 35 per cent? Why is government continuing to stymie one group of companies that is trying to invest in the infrastructure that will serve consumers and provide full competition in the wireline broadband market? Regulation is appropriate only where markets have failed, and it should not be imposed in anticipation of problems that do not exist. Cable was freed of this burden by the "96 Act and transformed its coaxial network into the high-speed network it now touts.

Third, we need the FCC to finish the job on broadband NOW. It needs to classify our broadband services the same way it already has classified comparable services provided by the dominant cable companies. The FCC should first decide that all broadband services should not be regulated under Title II, and instead should be classified under Title I of the Communications Act. Broadband is not telephony, and it should not be regulated like telephony. Imposing old telephony rules on broadband makes no sense.

And we need the FCC to reform the irrational and destructive pricing rules that are siphoning away money that could otherwise go to support new investment, and that instead is going to line the pockets of arbitrageurs who make no investment. To the extent we have continuing obligations to make elements of our network available for use by competitors, we should receive a fair price that lets us recover the prices we incur in the real world to provide those elements.

And, if investments and deployment plans are to be made now, we—Verizon, the industry and the public "need these things done now, without further delay.

OTHER INTERNET ISSUES

As we move toward a broadband world, the Commission is being asked at the same time to put new rules in place relating to broadband. Some have expressed concern that broadband network providers could discriminate against application providers or Internet service providers or try to keep customers from accessing services on the Internet that compete with services, like VOIP, that the broadband providers are offering.

The Internet is built on layers of services, networks and technologies. The operating system in your PC is at one layer or level; the ISPs are another layer; applications, like e-mail, are another layer; and the network infrastructure—the broadband loop into your home—is another. Every layer is distinct but they all must work together in order to provide consumers with information or services they want. This

[10] *R. Sachs, President, National Cable Telecommunications Association, "The New Broadband Internet Paradigm," Remarks to NARUC/NECA Summit on Broadband Deployment II, Arlington, Virginia April 28, 2003, page 1.*

[11] *National Cable and Telecommunications Association web site, accessed July 16, 2003, http://www.ncta.com/industry—overview/indStats.cfm?statID=15.*

is what I call the "Internet's Value Chain" and in order for it to work for the consumer, every layer—or link in the chain—must do its part.

Microsoft, Amazon, Earthlink, and many other players provide links or parts of links in the Internet's Value Chain. There are things that any one of these players might do that could be harmful to the openness of the Internet—but they aren't regulated, and I don't think anyone would seriously suggest they should be regulated. Yet, that is what some are advocating for network providers like Verizon. What is being suggested is pure anticipatory regulation. There is no need for this. We should be patient and not permit the heavy hand of regulation to skew the market forces that will determine what consumers want, how they want it, and what they are willing to pay for it. I do not see how it is in the interest of any player in Internet space, in the market right now, to be enacting anticipatory regulation of the Internet experience.

We think that the High Tech Broadband Coalition principles are worthy of being embraced by the FCC. Those principles are designed to ensure that the consumer has access all the services available on the Internet. And we believe that it's important that consumers have access to the Internet no matter whether the wires belong to Verizon or someone else.

There is no need, however, to chisel these principles into regulation. Rather, the FCC should allow the industry to follow this vision. The FCC, by endorsing these principles, can put the industry on notice. This will have tremendous impact on the way in which the market develops.

Put in simple terms the FCC should endorse these important industry principles, let the market develop and allow all new services to be offered in a "regulatory free" zone.

CONCLUSION

The key to reinvigorating the telecommunications industry is to send strong, consistent signals that uncertainty in policy is about to end and national policies will be adopted forthwith that support, not impede, investment. We're ready to do our part. If the government soon makes the right policy changes, broadband can be a true American success story and help to re-ignite the economy.Thank you.

Mr. UPTON. Mr. Jones, before you go, I want to recognize the chairman for a point of personal privilege.

Chairman TAUZIN. I thank the chairman for that privilege.

Let me, first of all, announce to the members of the committee and the audience that we are privileged to have with us a group of young people in the audience who have just shown up. They are from my home district in Louisiana. They are all high schoolers, and they just attended a session at Nicholls State University. Mr. Markey, that is my alma mater. We affectionately call it "Harvard on the Bayou" in Louisiana. These young people attended a session known as Free Enterprise Institute which is a session where they learn the principles of free market and free enterprise. What a great time for them to be here visiting the committee at this time.

But I wanted to welcome them all. They are winners of the right to attend a week here in Washington where they can see their government at work, and they are accompanied by a very special lady in my life. My daughter Kristie Tauzin is with them. If you will please give all of them a big welcome, I would appreciate it.

And I yield to my friend Mr. Markey.

Mr. MARKEY. I think it is important to note that you are a graduate of Nicholls State University.

Chairman TAUZIN. It is important to know I graduated anywhere, Mr. Markey.

Mr. MARKEY. Well, I know. I think the audience should know that. And as a result, you know, up in Boston we oftentimes refer to Harvard as the Nicholls State University of Massachusetts, because of the obvious intelligence and fine education that you——

Chairman TAUZIN. I appreciate that. We park our cars down on the bayou, too, Mr. Markey.

Mr. UPTON. Mr. Jones.

STATEMENT OF THOMAS JONES

Mr. JONES. Thank you, Chairman Upton, ranking member and members of the subcommittee for the opportunity to testify today.

My name is Thomas Jones. I am a partner in the law firm of Willkie Farr & Gallagher. I am testifying today on behalf of three competitive local exchange carriers, or CLECs: Allegiance Telecom, Conversent Communications and Time Warner Telecom.

Allegiance, Conversent and Time Warner Telecom are all facilities-based CLECs that serve business customers. Allegiance and Conversent deploy their own switches, but they rely on the right established in the Telecommunications Act of 1996 to use unbundled broadband loops from the ILECs to provide telephone and broadband data services to small- and medium-sized business customers. Time Warner Telecom uses its own facilities to provide voice and broadband services to medium and large business customers but must still purchase broadband end user connections from ILECs to serve many of its business customers.

I would like to explain today why the FCC's proposal to reclassify the transmission used in ILEC broadband Internet access as an unregulated Title I service threatens Congress' established telecommunications policy goals in two fundamental ways. First, by reclassifying these services out of Title II and reversing decades of precedent, the FCC would eliminate the ILEC's obligation to sell broadband loops to their CLEC competitors. For most small- and medium-sized business customers, the ILECs own the only broadband loops. No other service provider, including cable, wireless or satellite, has deployed ubiquitous business end user connections that have the upstream capacity, reliability and security features that the ILEC loops have.

Therefore, the only way for CLECs to serve the business market is by purchasing ILEC broadband loops. Eliminating their right to do so under Title II, which mandates reasonable prices and service quality, will likely destroy competition in this dynamic and innovative segment of the economy.

The purported goal of the FCC's proposal is to treat ILEC broadband and cable modem services the same way. However, the end result of reclassifying ILEC broadband transmission as a Title I service would be to throw the baby out with the bath water. ILECs would no longer be required to share broadband loops in the residential mass market in which the cable companies do compete, but ILECs would also no longer be required to provide broadband loops in the business broadband markets in which cable usually does not compete and in which the ILECs usually have the only viable end user connections.

If the FCC wants to consider deregulating certain aspects of ILEC broadband transmission, it can only do so within the scope of its statutory authority established by Congress in the Communications Act. To the extent that there is any justification for deregulating the ILECs—and it is our testimony that the ILEC's market power does continue to warrant regulation—then the FCC

must justify such deregulation under the standards set forth by Congress in section 10 of the Act. That provision gives the FCC the authority to target forbearance to markets where the ILECs lack market power. For both a policy and legal perspective, section 10 is the only legitimate vehicle for deregulating ILEC broadband.

Second, reclassifying the broadband transmission used to provide ILEC Internet access as a Title I service threatens many core social and national security policy objectives established by Congress. For example, the FCC's proposal could cause statutory requirements regarding universal service, privacy, access to the disabled and unauthorized changes in service providers to become inapplicable to broadband. Moreover, the requirements of the Communications Assistance for Law Enforcement Act, or CALEA, might not apply.

While some observers belief that the FCC can selectively reimpose these requirements under Title II, I respectfully submit that such an effort is beyond the FCC's jurisdiction. The Communications Act specifically states that the requirements of Title II only apply to the extent a telecommunications carrier is engaged in providing telecommunications services. Reclassification would mean that the ILECs would not be providing broadband as a telecommunications service, and the Supreme Court precedent does teach that the FCC may not rely on Title I authority to change that fact.

In sum, we urge Congress to remind the FCC that it lacks the authority to interpret Title II out of the Act whenever it pleases. Congress has specified the mechanism that the agency may use to deregulate as warranted without negative consequences for competition and other congressional goals. That mechanism is selective deregulation under section 10, not reclassification.

Again, thank you for allowing me to participate here today, and I would be happy to answer any questions.

[The prepared statement of Thomas Jones follows:]

PREPARED STATEMENT OF THOMAS JONES, WILLKIE FARR & GALLAGHER, ON BEHALF OF ALLEGIANCE TELECOM, CONVERSENT COMMUNICATIONS AND TIME WARNER TELECOM

I want to begin by thanking Chairman Upton, Ranking Member Markey, and the Members of the subcommittee for the opportunity to testify today. My name is Thomas Jones. I am a partner in the law firm of Willkie Farr & Gallagher. I am testifying today on behalf of three competitive local exchange carriers or "CLECs": Allegiance Telecom, Conversent Communications, and Time Warner Telecom. I would ask that in addition to my testimony today, you include in the record a joint paper to be filed by these companies in the FCC's Title I proceeding.

Allegiance, Conversent and Time Warner Telecom are all facilities-based CLECs that serve business customers. Allegiance and Conversent deploy their own switches, but they rely on the right established in the Telecommunications Act of 1996 to use unbundled broadband loops from the ILECs to provide telephone and broadband data services to small and medium-sized business customers. Time Warner Telecom uses its own facilities to provide voice and broadband services to medium and large business customers, but must still purchase broadband loops from the ILECs to serve many of its business customers.

I would like to explain today why the FCC's proposal to reclassify the transmission used in ILEC broadband Internet access as an unregulated Title I service threatens Congress' established telecommunications policies in two fundamental ways. *First,* by reclassifying these services out of Title II and reversing decades of precedent, the FCC would eliminate the ILECs' obligation to sell broadband loops to their CLEC competitors. For most small and medium-sized business customers, the ILECs own the only broadband loops. No other service provider, including cable, wireless or satellite, has deployed ubiquitous business end user connections that

have the upstream capacity, reliability and security features of ILEC loops. The ILECs' market power over business loops remains, regardless of what is sent over its loop facilities, whether it be broadband or narrowband, or if the loop is old, new, borrowed or blue. Therefore, the only way for CLECs to serve the business market is by purchasing ILEC broadband loops. Eliminating their right to do so under Title II, which mandates reasonable prices and service quality, will likely destroy competition in this dynamic and innovative segment of the economy.

The purported goal of the FCC's proposal is to treat ILEC broadband and cable modem services the same way. However, the end result of reclassifying ILEC broadband transmission as a Title I service would be to throw the baby out with the bath water. ILECs would no longer be required to share broadband loops in the residential/mass market in which cable competes, but ILECs would also no longer be required to provide broadband loops in the *business* broadband markets in which cable usually does *not* compete and in which the ILECs usually own the only broadband end user connections.

If the FCC wants to consider deregulating certain aspects of ILEC broadband transmission, it can only do so within the scope of its statutory authority established by Congress in the Communications Act. To the extent that there is any justification for deregulating the ILECs, and it is our testimony that ILECs' market power continues to warrant regulation, then the FCC must justify such deregulation under the standards set forth by Congress in Section 10 of the Act.[1] That provision gives the FCC the authority to target forbearance to markets where the ILECs lack market power. From both a policy and legal perspective, Section 10 is the only legitimate vehicle for deregulating ILEC broadband.

Second, reclassifying the broadband transmission used to provide ILEC Internet access as a Title I service threatens many core social and national security policy objectives established by Congress. For example, the FCC's proposal could cause statutory requirements regarding universal service, privacy, access to the disabled, and unauthorized changes in service providers to become inapplicable to broadband. Moreover, the requirements of the Communications Assistance for Law Enforcement Act (CALEA) might not apply to transmissions delivered over broadband, including voice over IP.

While some observers believe the FCC can selectively reimpose these requirements under Title I, I respectfully submit that such an effort is beyond the FCC's jurisdiction. The Communications Act specifically states that the requirements of Title II only apply to the extent a telecommunications carrier is engaged in providing telecommunications services. Reclassification would mean that ILECs would not be providing broadband as telecommunications services, and Supreme Court precedent teaches that the FCC may not rely on its Title I authority to change that fact.

In sum, we urge Congress to remind the FCC that it lacks the authority to interpret Title II out of the Act whenever it pleases. Congress has specified the mechanism that the agency may use to deregulate as warranted without negative consequences for competition and other congressional goals—that mechanism is Section 10, not reclassification.

Again, thank you for allowing me to participate here today, and I would be happy to answer any questions.

APPENDIX

SEC. 10. [47 U.S.C. 160] COMPETITION IN PROVISION OF TELECOMMUNICATIONS SERVICE.

(a) REGULATORY FLEXIBILITY.—Notwithstanding section 332(c)(1)(A) of this Act, the Commission shall forbear from applying any regulation or any provision of this Act to a telecommunications carrier or telecommunications service, or class of telecommunications carriers or telecommunications services, in any or some of its or their geographic markets, if the Commission determines that—

(1) enforcement of such regulation or provision is not necessary to ensure that the charges, practices, classifications, or regulations by, for, or in connection with that telecommunications carrier or telecommunications service are just and reasonable and are not unjustly or unreasonably discriminatory;

(2) enforcement of such regulation or provision is not necessary for the protection of consumers, and

(3) forbearance from applying such provision or regulation is consistent with the public interest.

[1] The full text of Section 10 is set forth in an appendix to this testimony.

(b) COMPETITIVE EFFECT TO BE WEIGHED.—In making the determination under subsection (a)(3), the Commission shall consider whether forbearance from enforcing the provision or regulation will promote competitive market conditions, including the extent to which such forbearance will enhance competition among providers of telecommunications services. If the Commission determines that such forbearance will promote competition among providers of telecommunications services, that determination may be the basis for a Commission finding that forbearance is in the public interest.

(c) PETITION FOR FORBEARANCE.—Any telecommunications carrier, or class of telecommunications carriers, may submit a petition to the Commission requesting that the Commission exercise the authority granted under this section with respect to that carrier or those carriers, or any services offered by that carrier or carriers. Any such petition shall be deemed granted if the Commission does not deny the petition for failure to meet the requirements for forbearance under subsection (a) within one year after the Commission receives it, unless the one-year period is extended by the Commission. The Commission may extend the initial one-year period by an additional 90 days if the Commission finds that an extension is necessary to meet the requirements of subsection (a). The Commission may grant or deny a petition in whole or in part and shall explain its decision in writing.

(d) LIMITATION.—Except as provided in section 251(f), the Commission may not forbear from applying the requirements of section 251(c) or 271 under subsection (a) of this section until it determines that those requirements have been fully implemented.

(e) STATE ENFORCEMENT AFTER COMMISSION FORBEARANCE.—A State commission may not continue to apply or enforce any provision of this Act that the Commission has determined to forbear from applying under subsection (a).

Mr. UPTON. Thank you. Mr. Sachs.

STATEMENT OF ROBERT SACHS

Mr. SACHS. Chairman Upton, Ranking Member Markey and members of the subcommittee, I appreciate this opportunity to share with you the cable industry's views regarding what regulation, if any, is appropriate for broadband Internet services. I would like to make three points.

First, the widespread availability of broadband Internet service across the U.S. Is largely the result of the cable industry's massive investment of private risk capital. This multibillion dollar investment has created a service that has proved to be a fast growing, highly valued consumer service.

Second, an important reason why the cable industry's risk taking has greatly enhanced the use of the Internet for millions of Americans is because FCC policies have avoided unnecessary regulation.

Third, the cable industry supports policies that favor broadband competition over regulation. In the absence of any market failure, and there is none in the broadband market, any government intervention should be aimed at deregulatory parity; that is, regulate down, not up.

It is really hard to believe that cable modem service has existed as a consumer service for only 7 years. I remember well one of the earliest public demonstrations of this new technology that my then employer Continental Cablevision conducted in the early nineties at the Museum of Science in Boston. Frankly few at the time believed that cable's hybrid fiber coax networks were suitable for data transmission. After all, cable was low tech, but the demo made instant converts.

To the credit of an entrepreneurial industry that was willing to take the risks, broadband has come a long way in a relatively short period of time. Cable broadband is now available to almost 85 percent of U.S. Households. This massive undertaking has involved

upgrading over a million miles of cable plant with fiber optics and the latest digital technology.

More than 12 million households today subscribe to cable modem service. Among cable households that own PCs, over 25 percent are cable modem customers. Cable modem service gives consumers instantaneous access to the Internet and everything that is available on it.

Companies have experimented with different business models. Some offer tiers. Some offer unique broadband content. All allow customers to choose their own home page with unfettered access to any content on the Internet.

Government regulatory policies can have strong effects on how rapidly broadband gains mass market. The FCC's approach to cable modem services certainly helped its development. In 1999, at the urging of dial-up ISPs and our telephone competitors, the FCC intensively studied whether it should mandate access for competitive ISPs on the cable platform on government-set terms and conditions; in other words, common carriage.

Our industry argued, indeed we committed that we would build out our broadband networks aggressively if we were not burdened by this type of costly and intrusive regulation. Forcing common carriage on cable would only delay deployment, we said. The FCC's decision not to head down the road of regulation allowed us to keep our commitment.

By 2002, court cases led the FCC to decide the regulatory classification of cable modem service. The FCC concluded that this service is an interstate information service and not a cable service nor a telecommunications service. In a further rulemaking the FCC is currently considering the full implications of its classification of cable modem service as an information service, which brings me to my final point.

To the extent the FCC believes that cable modem and DSL services should be subject to some version of equivalent regulation, it should adopt, as you said, Mr. Chairman, deregulatory parity; that is, the Commission should remove regulatory constraints, not add new ones.

NCTA has not participated in the FCC's rulemaking on the regulatory treatment of DSL. However, as a general principle we favor market competition over regulation and do not seek to impose regulatory requirements on competitors.

We do take issue with the suggestion by some companies that if DSL service remains subject in whole or in part to Title II regulation, cable modem service should be subjected to equivalent regulation. ILECs are subject to Title II constraints for reasons related to their unique history and network characteristics. Imposing legacy phone regulations on cable for no reason other than to achieve regulatory parity would harm consumers by raising the price or lowering the quality of cable modem service. It would also provide a disincentive for new investment.

Promoting competition rather than regulating competitors should be the cornerstone of U.S. Broadband policy.

[The prepared statement of Robert Sachs follows:]

PREPARED STATEMENT OF ROBERT SACHS, PRESIDENT AND CEO, NATIONAL CABLE AND TELECOMMUNICATIONS ASSOCIATION

Mr. Chairman, Ranking Member Markey, and Members of the Subcommittee: On behalf of the National Cable & Telecommunications Association, I appreciate this opportunity to share with you the cable industry's views regarding what regulatory treatment, if any, is appropriate for broadband Internet services.

In my testimony today, I'd like to make three points. First, the widespread availability of broadband Internet service across the U.S. is largely the result of the cable industry's massive investment of private risk capital. This multi-billion dollar investment has created a service that has proved to be a fast-growing, highly valued service by consumers. Second, an important reason that the cable industry's risk taking has greatly enhanced use of the Internet for millions of Americans is because FCC policies have avoided unnecessary regulation. Third, the cable industry supports policies that favor broadband competition over regulation. In the absence of any market failure—and there is none in the broadband market—any government intervention should be aimed at "deregulatory parity," that is, regulate down, not up.

It's really hard to believe that cable modem service has existed as a consumer service only for about seven years, with most deployment and growth taking place since 1999.

I remember well one of the earliest public demonstrations of this new technology that my then employer, Continental Cablevision, conducted in the early-1990's at the Museum of Science in Boston. Frankly, few at the time believed that cable's hybrid fiber coax networks were suitable for data transport. After all, cable was "low-tech." But the demo made instant converts.

To the credit of an entrepreneurial industry that was willing to take the risks, broadband has come a long way in a relatively short period of time. Cable operators made this investment without any clear understanding of how or whether government might decide to regulate this new service. And we continue to operate under some regulatory uncertainty.

Due in large measure to efforts of the cable industry, broadband is now available to more than 85% of U.S. households. This massive undertaking has involved upgrading over a million miles of plant with fiber optics and the latest digital technology.

More than 12 million consumer households subscribe to cable modem service. Over 15% of cable households today are cable modem customers. And among cable households that own PC's, over 25% are cable modem customers.

Cable internet access has been just that—access to the Internet and everything that's available on it. Companies have experimented with different business models. All allow consumers to choose their own home page with unfettered access to any content on the Internet.

Government regulatory policies can have strong effects on how rapidly broadband gains a mass market. The FCC's approach to cable modem service has certainly helped its development. In 1999, at the urging of dial-up ISP's and our telephone competitors, the FCC intensively studied whether it should mandate access for competitive ISP's on the cable platform on government-set terms and conditions. In other words, common carriage.

Some insisted that unless the FCC acted to mandate carriage of multiple ISPs before cable's networks were even built, the end-to-end openness of the Internet would be lost. Our industry argued—indeed, we committed—that we would build out our broadband networks aggressively if we were not burdened by this type of unnecessary regulatory restraint. Forcing common carriage on cable would only delay deployment, we said. The FCC's decision not to head down the road of regulation allowed us to keep our commitment. The FCC announced a policy of vigilant monitoring of developments and has since reported to Congress on the successful rapid deployment of broadband by cable.

By 2002, court cases led the FCC to decide the regulatory classification of cable modem service. The FCC concluded that cable modem service is an "interstate information service" and not a "cable service" nor a "telecommunications service."

The Commission examined the legislative history of the definition of "cable service" and concluded that it did not encompass the interactive access to the Internet that cable modem service affords to subscribers.

The Commission also found that the Communications Act did not permit the classification of cable modem service as a common carrier "telecommunications service." Such a service, by definition requires that the provider offer "telecommunications"—transmission capacity—*directly to the public for a fee,* something cable operators do

not do in the provision of cable modem service (or, for that matter, in providing traditional video programming services).

The Commission found that the transmission component of Internet access provided by cable operators is "part and parcel of cable modem service—integral to its other capabilities," not a separate transport facility made available for public use. It therefore concluded that cable modem service, like Internet access service offered by other entities, is an "information service" delivered to subscribers "via telecommunications" rather than separate offerings of content and common carrier transport.

The Commission's finding that the "information service" classification best fits the attributes of cable modem service is also consistent with Congress' direction to insure that the Internet remains "unfettered by Federal or State regulation," as much as possible. As you know, in a further rulemaking, the FCC is currently considering the full implications of its March 2002 decision.

Which brings me to my final point: to the extent the FCC believes that cable modem and DSL services should be subject to some version of equivalent regulation, it should adopt "deregulatory parity"—that is, the Commission should remove regulatory constraints, not add new ones.

NCTA has not participated in the FCC's rulemaking on the regulatory treatment of DSL, which the FCC is studying concurrently with its further notice on cable modem service. However, as a general matter, we favor market competition over regulation and do not seek to impose regulatory requirements on competitors.

We *do* take issue with the suggestion by some companies that if DSL service remains subject, in whole or in part, to Title II regulation, cable modem service should be subjected to equivalent regulation. ILEC's are subject to Title II constraints for reasons related to their unique history, system architecture, and past conduct—none of which pertain to cable. Imposing those legacy regulations—and the costs associated with them—on cable for no reason other than to achieve regulatory parity will harm consumers by raising the price or lowering the quality of cable modem service. It would also provide a disincentive for new investment.

Promoting competition rather than regulating competitors should be the cornerstone of U.S. broadband policy. The cable industry's record with respect to broadband deployment clearly demonstrates that consumer benefits result when government policies encourage companies to invest and compete in the market.

In closing, I'm reminded of the wisdom of Thomas Jefferson, himself one of America's greatest innovators, who said: "That government is best which governs the least, because its people discipline themselves." A modern-day corollary for broadband Internet might be: That *government is best which governs the least, because market forces provide discipline.*

Mr. Chairman, we've come a long way in relatively short period of time in making broadband services widely available in the U.S. The challenges ahead are to make broadband ubiquitous in rural and urban America alike, enhance network capabilities and develop unique broadband content and applications that will further drive market penetration. I urge you and your colleagues to encourage the FCC to continue to give broadband Internet providers the market freedom to achieve these goals.

Thank you.

Mr. UPTON. Thank you very much. Mr. Baker.

STATEMENT OF DAVID BAKER

Mr. BAKER. Chairman Upton, Ranking Member Markey and members of the subcommittee, thank you for the opportunity to testify before you today. I am Dave Baker, Vice President for Law and Public Policy with EarthLink. EarthLink is the Nation's third largest Internet service provider, serving 5 million customers nationwide with dial-up, broadband, Web posting and wireless Internet services.

This hearing is about the regulatory status of broadband services. As members of the subcommittee are aware, this question has been the focus of several ongoing proceedings at the Federal Communications Commission. The law is clear about this regulatory status, and EarthLink is dismayed that the FCC is misconstruing the law and tilting the playing field in favor of incoming providers.

What is particularly troubling to EarthLink, and I would hope would be troubling to members of this subcommittee and the Congress as well, is the tremendous and far reaching effort of classifying the facilities used to provide broadband services as information services under the Communications Act. Common carrier transmission services that are the foundation of the information economy would no longer be required to be made available to information service providers upon reasonable requests on nondiscriminatory terms and conditions. Network owners would be free to arbitrarily decide who can use their networks, at what price and on what terms. This would not only work against consumer interests but even laws like CALEA would no longer apply.

The central question of this hearing and of several current FCC proceedings is the regulatory classification of broadband services. Let me be clear in answering this question. All Internet services, whether provided by an independent ISP like EarthLink, a telco affiliate like Verizon Online or a cable company like Comcast, are information services. Let me be equally clear that all information services are by definition delivered via telecommunications and that offering of such telecommunications, whether by a telco or a cable company, makes them telecommunication services. This is true whether the Internet access is provided by an independent ISP or the network operators themselves. Internet access, broadband or otherwise, is therefore an information service riding on top of a transmission component which is a telecommunications service.

In the world of dial-up Internet access these two components are easy to see. Consumers purchase their phone line from their telephone company and their Internet service from an ISP such as EarthLink. The telephone company provides the telecommunications service which can be used to transmit voice or data. The ISP provides an information service. The underlying transmission link is regulated. The Internet access is an unregulated information service.

Now suppose the ISP I just described was Verizon Online. It would make no difference. The underlying transmission provided by Verizon would still be a regulated common carrier telecommunications service and Verizon Online's Internet access service would still be an unregulated information service. This is the regime that the FCC crafted in its seminal 1980 Computer II proceeding, which has been affirmed by the FCC and Federal courts many times in the intervening years and which Congress adopted in the Telecommunications Act of 1996.

Broadband access is similar, with two exceptions. First, it is obviously faster because the transmission link has better electronics and greater capacity. Second, in most cases the end user is not given the option of buying the transmission link separately from the information service. Rather they buy a bundled package which combines the two. Further, most broadband ISPs are affiliated with or directly owned by the transmission facility owner.

In the case of broadband Internet access, the FCC is taking an approach opposite from the one which proved so successful in the narrowband world. For broadband the FCC suggests that so long as the facility owner refuses to offer consumers a separate trans-

mission link, the bundled package of transmission and information is an information service. As a result facility owners are able to shield their transmission networks from requirements for nondiscriminatory access that would otherwise apply. This all but eliminates competition among broadband ISPs, violating not only the letter and intent of the Telecommunications Act but also doing great harm to small businesses and consumers.

The structure that Congress enacted in the 1996 act mirrors the structure the FCC adopted in its Computer II decision. The transmission component integral to delivery and definition of information service is treated separately under the act just as the FCC treated it separately in its rulemakings 15 years prior to that. Only by adding words that don't exist such as separate and stand-alone does the FCC make their version and definitions work.

Telephone companies enjoyed a government grant of monopoly market for almost a century in which to build their transmission networks. Cable companies had similar monopoly franchises, the cable-telco cross ownership ban, and below cost access to ducts and poles in time to build out their networks. Telcos and cable enjoy 85 percent market share in their core businesses, which draws a steady stream of revenue to push into the information services market, and they have some 95 percent market share in broadband, DSL and cable modem markets respectively.

In summary, it is crucial to distinguish between broadband information services and the underlying telecom services which deliver them. Internet access services, whether narrowband or broadband, whether offered by an independent ISP or a cable company, remain unregulated information services but the transmission facilities which underlie them remain common carrier telecommunications services. To allow facility owners to now repudiate their obligation to share their transmission networks on a nondiscriminatory basis is an abuse of the law and is anticompetitive. Clearly that is not what Congress intended when it passed the 1996 act.

Thank you for giving me the opportunity to testify today.

[The prepared statement of David Baker follows:]

PREPARED STATEMENT OF DAVE BAKER, VICE PRESIDENT OF LAW AND PUBLIC POLICY, EARTHLINK, INC.

Mr. Chairman and members of the Subcommittee. Thank you for the opportunity to testify before you today. My name is Dave Baker. I am Vice President for Law and Public Policy for EarthLink. EarthLink is the nation's 3rd largest Internet Service Provider (ISP), serving 5 million customers nationwide with dial-up, broadband (DSL, cable and satellite), web hosting and wireless internet services. EarthLink regularly receives awards for its customer service and innovation, including the J.D. Power and Associates award for highest customer satisfaction among dial-up ISPs and (tie) highest customer satisfaction among broadband ISPs.

This hearing is about the regulatory status of broadband services, and in particular whether those services should be classified as "information services," "common carrier" services, or "something in between." As the members of the subcommittee are aware, this question has been the focus of several ongoing proceedings at the Federal Communications Commission (FCC). EarthLink is presently appealing in court the FCC's declaratory order in the proceeding dealing with the provision of broadband service over cable facilities, and is anxiously awaiting the FCC's action in the proceeding dealing with the provision of broadband services over telephone facilities.

To be frank, EarthLink is dismayed with the answers regarding the regulatory classification of broadband services that the FCC seems determined to reach. The law is clear about that regulatory status, and we are dismayed that the FCC seems

determined to ignore the law in an effort to tilt the playing field in favor of incumbent providers who have built their networks over public rights of way using federal authorization while protected from competition by federal, state or local government-granted monopolies.

What is particularly troubling to EarthLink, and I hope would be troubling to the members of this subcommittee and the Congress as a whole, is the tremendous and far reaching effect of classifying all broadband services as "information services" under the Communications Act. The effect is tremendous because of technology convergence. Digital, packet-switched transmission networks are replacing analog, circuit switched networks at an ever increasing rate. It will not be long before most, if not all, of the major network operators are able to provide all of their services—voice, data, and video—over packet-switched networks also used to provide Internet services.

The effect would be far reaching because the common carrier transmission services that are the foundation of the information economy would no longer be required to be made available to information service providers upon reasonable request on non-discriminatory terms and conditions. Network owners would be free to arbitrarily decide who can use their networks, at what price, and on what terms. This would not only work against consumer interests, but vital communications links that can be reached today under court order by law enforcement agencies would suddenly be beyond reach because laws like the Communications Assistance to Law Enforcement Act (CALEA) would no longer apply. Congress would have re-write an entire body of laws that have been carefully enacted over the years to promote competition, protect consumers, and provide for public safety. All because the FCC is ignoring not only its own precedents, but also the plain language that Congress wrote in the Telecommunications Act of 1996.

The central question of this hearing (and of several current FCC proceedings) is the regulatory classification of broadband services. Let me be clear in answering this question. All internet access services—whether provided by an independent ISP like EarthLink, a telco affiliate like Verizon Online, or a cable company like Comcast—are information services. Let me be equally clear that all information services are, by definition, delivered *via telecommunications,* and the offering of such telecommunications, whether by a telco or a cable company, for a fee to the public makes them telecommunications services. This is true whether the Internet access is provided by an independent ISP or by the network operators themselves. Internet access, broadband or otherwise, is therefore an information service riding on top of a transmission component which is a telecommunications service.

In the world of dial-up Internet access these two components are easy to see. Consumers purchase their phone line from their telephone company and their Internet service from an ISP such as EarthLink. The telephone company provides a telecommunications service which can be used to transmit voice or data. The ISP provides an information service. The consumer dials an EarthLink access number, which establishes an underlying transmission link through the customer's phone line; the consumer can then use EarthLink's services to access the Internet. The underlying transmission link is a regulated common carrier telecommunications service. The Internet access service is an unregulated information service.

Now suppose that the ISP in the dial-up scenario I just outlined was not EarthLink but Verizon Online. It would make no difference. The underlying transmission link (provided by Verizon in this case) would be regulated as a common carrier telecommunications service, but Verizon Online's Internet access service would still be an unregulated information service. This is the regime that the FCC crafted in its seminal 1980 *Computer II* proceeding, which has been affirmed by the FCC and federal courts many times in the intervening years, and which Congress adopted in the Telecommunications Act of 1996. The FCC created a level playing field by requiring that the underlying transmission link be made available by facility owners on a non-discriminatory basis to all ISPs and then treating all ISPs the same with respect to the unregulated nature of the information service component, regardless of whether or not the ISP was owned by the owner of the underlying transmission facility. As a result, competition in the provision of information services flourished because the facility owners—the telephone companies in the dial-up world—could not use their ownership of the underlying transmission facilities to leverage their position in the information services market.

Broadband Internet access works much the same as dial-up Internet access, with two exceptions. First, it is faster, because the transmission link has better electronics or greater capacity. Second, in most cases the end user isn't given the option of buying separately the transmission link from their home or office to the switch. Rather, they have to buy that portion of the link as part of a bundled package of services which combines the information service component provided by an ISP with

the transmission component provided by the telco or cable company. Furthermore, most broadband ISPs are affiliated with or directly owned by the transmission facility owner.

In the case of broadband Internet access, the FCC seems determined to take the exact opposite approach from the one that proved so successful for promoting competition in the dial-up world. For broadband, the FCC suggests that, so long as the facility owner refuses to offer consumers the option of buying the transmission link separately from the information services component, the bundled package of transmission and information service is an "information service" under the Communications Act. Therefore neither the information service component nor the underlying common carrier transmission link would be subject to regulation. As a result, facility operators are able to shield their transmission networks from requirements for non-discriminatory access by other ISPs. This all but eliminates competition among broadband Internet service providers and not only violates the letter and intent of the Telecommunications Act, but also does great harm to independent businesses and to consumers.

The FCC's interpretation is at odds with both the letter and the spirit of the Telecommunications Act of 1996. The Communications Act of 1934, as amended by the Telecommunications Act, defines "information service" as "the offering of a capability for generating, acquiring, storing, transforming, processing, retrieving, utilizing, or making available information *via telecommunications*." 47 U.S.C. 153(20). The term "telecommunications" is defined as "the transmission, between or among points specified by the user, of information of the user's choosing, without change in the form or content of the information as sent and received." 47 U.S.C. 153(43). As the statutory language makes clear, information services are made available to consumers using a transmission network. Up to this point I believe there is no disagreement among any of us sitting at the table. It is the next step which the Commission refuses to take, and over which there is disagreement among the witnesses today.

In 1996, when Congress added the terms "information service" and "telecommunications" to the Communications Act, they also added the terms "telecommunications service" and "telecommunications carrier." A "telecommunications service" is "the offering of telecommunications for a fee directly to the public, or to such classes of users as to be effectively available directly to the public, regardless of the facilities used." 47 U.S.C. 153(46). Any provider of telecommunications service is a "telecommunications carrier," and telecommunications carriers are to be treated as "common carriers" subject to regulation under Title II of the Communications Act. 47 U.S.C. 153(44).

The structure Congress enacted in 1996 mirrors the structure the FCC adopted in its 1980 *Computer II* decision. The definition of "information services" cross references the defined term "telecommunications," which in turn is incorporated in the definitions of both "telecommunications service" and "telecommunications carrier." The transmission component that is integral to the delivery and definition of "information service" is treated separately under the Act for regulatory purposes, just as transmission had been treated separately by the FCC for 15 years prior to the passage of the 1996 Act. The language of the definition of both "telecommunications carrier" and "telecommunications service" make plain that they are intended to apply broadly; they apply to "any provider" "regardless of the facilities used."

"Telecommunications carriers" and "telecommunications services" are the key terms that Congress used to define the pro-competitive provisions of the 1996 Act. Almost all of the rights and responsibilities in the 1996 Act attach or apply to telecommunications carriers, which the statute says are to be treated as common carriers to the extent they provide telecommunications services. Yet under the FCC's interpretation those terms would apply only to those facility owners who chose to make a "separate" or "stand-alone" offering of telecommunications to the public—those facility owners that chose instead to offer their telecommunications to the public only if the public also buys the facility owner's chosen information service get to escape regulation as a common carrier.

Two examples illustrate severe problems with the FCC's approach. First, consider the case of a competitor who seeks to offer information services in competition with the information services offered by a facility owner—say an RBOC or a cable company. If EarthLink wants to continue to compete in the information services market, but is now denied access to the broadband transmission networks needed to offer its services to consumers, then presumably EarthLink would have to build its own broadband facilities to reach consumers. Yet to build those facilities, EarthLink would have to become a common carrier in order to take advantage of any of the market opening provisions Congress enacted in 1996. Those provisions only apply to telecommunications carriers and telecommunications services. At the same time,

EarthLink's competitors, the RBOCs and cable companies, who already have existing transmission networks that reach almost every customer, would be unregulated with respect to the same transmission services for which EarthLink would be regulated.

Going back to the days of old Ma Bell AT&T, the telephone companies enjoyed a government-granted monopoly market for almost a century in which to build out their transmission networks. The cable companies had monopoly franchises, the federal cable-telco cross ownership ban, and below cost access to ducts and poles for over 15 years in which to build out their networks. Today the telephone companies and the cable companies still each have 85% or more of the customers in their core business—phone or cable—from which to draw a steady revenue stream as they push into the information services market. And they have some 95% market share of all broadband DSL or cable modem customers, respectively. Yet EarthLink and other potential competitors to these incumbent facility owners would, under the FCC's interpretation, have to undertake the impossible task of building their own last-mile network—without any protection or subsidy—in order to continue to compete in the information services business. This result stands the 1996 Act on its head.

Second, the FCC's own documents demonstrate that their interpretation can only work if words are added to the statutory language that Congress adopted in 1996. The statutory definition of "telecommunications service" states that such service is "the offering telecommunications for a fee directly to the public" without qualification. But the FCC, in both their declaratory order in the cable modem proceeding and in their briefs defending that order to the Court of Appeals for the Ninth Circuit, insists that a telecommunications service only exists if there is a "stand-alone" offering for a "separate" fee. Only by adding words that don't exist in the statute can the FCC make their version work.

In summary, it is crucial to distinguish between broadband information services and the underlying telecommunications services which deliver them. Internet access services, whether narrowband or broadband, and whether offered by an independent ISP, an RBOC, or a cable company, remain unregulated information services. But the facility based transmission services that underlie all information services remain common carrier telecommunications services, regardless of whose broadband Internet service the customer subscribes to and whether or not the facilities operator offers those transmission services separately to consumers or as part of a combined package of services that includes information services. Consumers and the economy have benefited over the past twenty plus years from robust competition in an unregulated information services industry. That unregulated competition in information services was made possible because the underlying transmission networks remained subject to regulations that require that they be offered to all ISPs on non-discriminatory terms and conditions.

In most areas of the country today there are at best two broadband networks; for many residential consumers there is effectively only one. Both the telephone networks and the cable networks were built with government-granted monopolies over public rights of ways using Federal authority using rate-payer money. To allow these facility owners to now repudiate their obligation to share those transmission networks on a non-discriminatory basis with others who seek to offer telecommunications or information services to the public is an abuse of the law and is anti-competitive. Such an approach would take a robustly competitive and level playing field and tilt it heavily in favor of a few players by allowing them to leverage their transmission facility monopoly into domination of new areas and services. Clearly that was not what Congress wrote or intended when it passed the 1996 Act.

Thank you again for the opportunity to testify today. I would be happy to answer any questions.

Mr. UPTON. Ms. Goldman.

STATEMENT OF DEBBIE GOLDMAN

Ms. GOLDMAN. Good afternoon, Mr. Chairman and members of the committee. Thank you for the opportunity to appear before you today. My name is Debbie Goldman. I am the Policy Chair of the Alliance for Public Technology. I am also a research economist with the Communications Workers of America. However, I want to emphasize I am representing the Alliance for Public Technology.

For nearly 15 years, the Alliance for Public Technology has promoted the benefits of universal affordable deployment of advanced

telecommunication services. Many of our members represent traditionally underserved communities, rural residents, minorities, people with disabilities, low income households and senior citizens.

It is critically important for the FCC to establish a regulatory framework that encourages investment in broadband technology to ensure affordable access for all Americans. High-speed Internet access provides a multitude of social benefits from economic development and health care to education and lifelong learning for workers to public safety and independence for people with disabilities.

I will include in the record a recent APT report entitled "A Broadband World: The Promise of Advanced Services." this report highlights the many social and economic benefits of broadband technology. It finds that the benefits of broadband grow exponentially, and prices become more affordable, as more people are connected to the network. Therefore, public policy must make sure that universal affordable broadband is available to everyone.

The FCC must therefore adopt a common regulatory framework for all broadband services regardless of the technology. The emerging broadband market is characterized by fierce cross-platform competition between cable and wireline telephony. The cable modems are beating DSL two to one, in large part due to regulatory advantage.

The framework must facilitate a robust marketplace where multiple providers using a variety of technologies compete on a level regulatory playing field to offer consumers a wide variety of services at attractive prices. It must encourage investment and next generation broadband networks.

The FCC took a step in the right direction in what we believe will be the final text of the Triennial Review. By freeing the broadband networks of the wireline carriers from unbundling and retail price regulation, the investment incentives are set in the right place.

The regulatory framework must also continue the openness that has characterized the Internet in the narrowband environment where content providers have nondiscriminatory access to the networks. Regulatory policy must ensure that broadband networks remain open to all content providers so users have access to diverse information sources of their own choosing.

The broadband regulatory framework must also continue consumer protections that have been so critical in the voice environment. These include accessibility requirements for people with disabilities. Currently the accessibility requirements are required only for voice telephone. Unless these protections are extended to broadband many people with disabilities will not be able to access much of the content available over broadband networks.

And finally, we must update our universal service support system for the broadband world. All broadband providers regardless of the technology must be required to contribute to the universal service fund. All broadband providers regardless of the technology must be required to contribute to the universal service fund.

In the current debate about the proper regulatory treatment of broadband, the Alliance for Public Technology has urged the FCC to develop a new framework modeled on using the language in sec-

tion 706 of the Telecommunications Act, and this is the only section of that act that specifically addresses advanced telecom technology.

Section 706 of the act establishes in law the goal of universal access to advanced telecommunications services by all Americans. Section 706 provides the FCC with the authority to develop regulating methods to achieve that goal. Therefore, the Alliance believes that the FCC should use the umbrella language of section 706 to craft a new regulatory framework for all broadband.

When the FCC began and then completed these series of proceedings known as Computer I and then II and then III, the proceedings were designed to develop a regulatory framework for computer enabled services transmitted over the telephone network. The Commission developed a definition of information services that distinguished these unregulated offerings from the regulated monopoly telecom services.

As the current definitional controversy demonstrates, it is becoming increasingly difficult to squeeze broadband into this framework. At the time of the Computer proceedings no one envisioned cable or wireless as technology platforms capable of delivering two-way high-speed digital information to homes and businesses, yet today that is where we are with the convergence of technology. Yet each technology platform is subject to a different regulatory regime.

Therefore, we believe constructing a new regulatory framework consistent with the principles I have outlined using the language of section 706 would provide multiple advantages. It would allow for a single regulatory treatment for all broadband in a technology neutral fashion. It does not attempt to force broadband into definitions created for different services. It reduces regulatory barriers to deployment and investment, provides important consumer protections for people with disabilities and would allow updating the system of universal service support.

Thank you, Mr. Chairman, and members of the committee.

[The prepared statement of Debbie Goldman follows:]

PREPARED STATEMENT OF DEBBIE GOLDMAN, POLICY COMMITTEE CHAIR, ALLIANCE FOR PUBLIC TECHNOLOGY

Good afternoon, Mr. Chairman and members of the committee. Thank you for the opportunity to appear before you today.

My name is Debbie Goldman. I am the Policy Chair of the Alliance for Public Technology. I am also a Research Economist with the Communications Workers of America. Today, I am representing the Alliance.

For nearly fifteen years, the Alliance for Public Technology, or APT, has promoted the benefits of universal, affordable deployment of broadband and advanced telecommunications services. Many members of APT represent traditionally underserved communities, including rural residents, minorities, people with disabilities, low-income households, and senior citizens.

It is critically important for the FCC to establish a regulatory framework that encourages investment in broadband technology to ensure affordable access for all Americans. High-speed Internet access provides a multitude of social benefits, from economic development and health care, to education and lifelong learning for workers, to public safety and independence for people with disabilities.

I will include in the record a recent APT report entitled "A Broadband World: The Promise of Advanced Services." The report highlights the many social and economic benefits of broadband technology. It finds that the benefits of broadband technology grow exponentially—and prices become more affordable—as more people are connected to a broadband network. Thus, public policy must ensure universal, affordable broadband deployment in order to serve economic and social goals.

It is imperative, therefore, that the FCC gets the regulatory framework right for broadband services. The FCC must adopt a common regulatory framework for all

broadband services, regardless of the technology. The nascent broadband market is characterized by fierce cross-platform competition between cable and wireline telephony. But cable modems are beating DSL 2 to 1, in large part due to regulatory advantages.

The framework must facilitate a robust marketplace where multiple providers compete on a level regulatory playing field to offer consumers a variety of services at attractive prices. It must encourage investment in next-generation broadband networks.

The FCC took at step in the right direction in its Triennial Review. Freeing wireline carriers' broadband networks from unbundling and retail price regulation gets the investment incentives right.

The framework must also continue the openness that has characterized the Internet in the narrowband environment, where content providers have nondiscriminatory access to the networks. Regulatory policy must ensure that broadband networks remain open to all content providers, so that users have access to diverse information sources of their own choosing. Open networks foster innovation of new services, and demand for even more network capacity.

The new broadband regulatory framework must also continue consumer protections that have been so critical in the voice environment. These include accessibility requirements for people with disabilities. Currently, accessibility requirements are required only for voice telephony services. Unless these protections are extended to the broadband environment, many people with disabilities will not be able to access much of the content available over broadband networks.

Finally, we must update our universal service support system for the increasingly broadband world. All broadband providers, regardless of the technology, must be required to contribute to the universal service fund.

In the current debate about the proper regulatory treatment of broadband, APT has urged the FCC to develop a new regulatory framework for broadband. We have encouraged the FCC to build upon Section 706 of the Telecommunications Act, the only section of the Act that specifically addresses advanced telecommunications technology.

Section 706 of the Act establishes in law the goal of universal access to advanced telecommunications services by all Americans. Section 706 also provides the FCC with the authority to develop "regulating methods" to achieve that goal. APT believes that the FCC should use the umbrella language of Section 706 to craft a new regulatory framework for broadband.

Decades ago, the FCC began a series of proceedings known as Computer I, II, and III. These proceedings were designed to develop a regulatory framework for computer-enabled services that were transmitted over the telephone network. The Commission developed a definition of "information services" that distinguished these unregulated offerings from the regulated, monopoly "telecommunications services."

As the current definitional controversy demonstrates, it is becoming increasingly difficult to squeeze broadband into this framework. At the time of the Computer proceedings, none envisioned cable or wireless as technology platforms capable of delivering two-way high-speed digital information to homes and businesses. Yet, today we are experiencing a convergence of different technology platforms, each capable of delivering digital data over high-speed networks. But each technology platform is subject to a different regulatory regime.

Constructing a new regulatory framework, consistent with the principles I have outlined, provides multiple advantages. It allows for a single regulatory treatment for all broadband services in a technology neutral fashion. It does not attempt to force broadband into definitions created for different technology platforms. It reduces regulatory barriers to deployment and investment, provides important consumer protections for people with disabilities, and updates the system of universal service support.

APT believes this framework can provide a manageable regulatory structure that will increase investment and deployment, create meaningful facilities-based broadband competition between different technologies, and bring the benefits of broadband to more Americans.

Thank you, Mr. Chairman and members of the committee.

Mr. UPTON. Thank you very much.

Mr. Misener.

STATEMENT OF PAUL MISENER

Mr. MISENER. Good afternoon, Chairman Upton and members of the committee. My name is Paul Misener and I am Amazon.com's

Vice President for Global Public Policy. I do appreciate very much being invited to testify today on this very important matter. Today I am representing not only my own company but also the Coalition of Broadband Users and Innovators, which is a collaboration of consumer groups and industry.

Mr. Chairman, unimpeded connectivity is the defining characteristic of the Internet, which was developed during the cold war specifically as a means to communicate within the United States after a nuclear attack on our country. As the Internet evolved from its military origins to be used primarily for informational, social and commercial purposes, its unimpeded connectivity took on a new meaning. Almost overnight American consumers found they are able to obtain for free or purchase any information, products or services that other people made available on the Internet. Thus, consumer access to Internet content historically has not been blocked or otherwise impeded by network operators.

The Coalition's sole purpose is to preserve the unimpeded connectivity of the Internet. We do not believe the network operators with market power should be permitted to impair access for any reason other than routine network management, and we have asked the FCC to adopt specific safeguards so unimpeded connectivity is maintained as American households increasingly rely on broadband connections.

Mr. Chairman, there are three key reasons the Coalition fears impediments to broadband consumer access. First, through our technical opportunities broadband consumer access is completely digital and thus, as the FCC has already determined, service providers can impair connectivity in ways that were virtually impossible in the narrowband analog dial-up world. For instance, a consumer attempting to reach the Web site for Joe's Pizza might find access blocked or impaired by a network operator that has a contract with David's Pizza, a competitor to Joe's.

Second, there are economic incentives. Broadband service providers, especially those that are vertically integrated, also have clear economic incentives to impair consumer access. The frequent allegation by some broadband network operators that an impairment prohibition would hurt investment makes sense only if these service providers count on profiting from impairments.

And third, there is market power. For the next several years while broadband service providers have market power, competitive forces will not be able to check their technical opportunities and economic incentives to impair consumer access. Put another way, absent regulatory intervention, consumers will have no choice but to accept impairments until true competition emerges.

The Coalition is aware of current impairments of consumer access and also has strong indications that strong broadband service providers are poised to exercise their market power to impair at will. But even if there were no current problems or if they were deemed too insignificant to matter, the Coalition believes that widespread current problems are not a necessary precondition for Commission action. To the contrary, the FCC by its very nature is a forward looking regulatory agency that is responsible not just for evaluating past and current conditions, but also predicting for future circumstances and acting in anticipation.

The cable industry itself, notwithstanding its professed philosophical opposition to anticipatory regulation, has on many occasions sought government intervention to prevent purely prospective harms. Congress has already given the FCC the statutory authority to ban impairments of the sort the Coalition fears, and the Congressional mandate to the Commission is clear: Ensure that the Internet remains a viable source for consumers and adopt policies to promote its widespread use.

We simply are urging the FCC to meet Congress's directive. FCC action is needed to prohibit impairments until true competition emerges. Without Commission action, broadband service providers with market power will have the technical opportunities and economic incentives to impair consumer access. If they were permitted to destroy unimpeded connectivity in this way, the anticompetitive exercise of market power by a handful of broadband network operators could do to the Internet what even a nuclear strike could not.

In conclusion, Mr. Chairman, the defining characteristic of the Internet is unimpeded connectivity. Americans today may obtain on-line any lawful information, products or services available or sold on the Internet without any discriminatory impairment by network operators. The Coalition's sole purpose is to preserve this unimpeded connectivity, and we have asked the FCC to use its existing statutory authority to prohibit impairments unrelated to legitimate network management until true broadband access competition emerges.

Mr. Chairman, we now ask that you and your subcommittee strongly urge the Commission to adopt this important safeguard to preserve unimpaired consumer connectivity to the Internet. Thank you again for inviting me to testify. I do look forward to your questions.

[The prepared statement of Paul Misener follows:]

PREPARED STATEMENT OF PAUL MISENER, VICE PRESIDENT FOR GLOBAL PUBLIC POLICY, AMAZON.COM

Good afternoon, Chairman Upton, Mr. Markey, and members of the Subcommittee. My name is Paul Misener. I am Amazon.com's Vice President for Global Public Policy. Thank you very much for inviting me to testify on this important matter. Today I am representing both my company and the Coalition of Broadband Users and Innovators. I respectfully request that my entire written statement be included in the record of this hearing.

Mr. Chairman, the defining characteristic of the Internet is unimpeded connectivity. Americans today may obtain online any lawful information, products, or services available or sold on the Internet, without any discriminatory interference or impairment by network operators. The Coalition's sole purpose is to preserve this unimpeded connectivity despite the changing technical, economic, and regulatory circumstances of consumer Internet access. Unfortunately, the Coalition has many reasons to fear for the future of unimpeded connectivity, because providers of broadband consumer access now have the technical opportunities, economic incentives and, most importantly, the market power to impair consumer access to Internet content. For these reasons, we have asked the FCC to use its existing statutory authority to prohibit any impairments unrelated to legitimate network management until true broadband access competition emerges. Mr. Chairman, we now ask that you and your Subcommittee strongly urge the Commission to adopt this important pro-consumer safeguard to preserve unimpaired connectivity to the Internet.

ABOUT AMAZON.COM AND THE COALITION

Amazon.com is America's leading online retailer. We are not a provider of broadband or Internet access service, nor do we have plans to become one. Amazon.com is a member of the Coalition of Broadband Users and Innovators (the "Coa-

lition"), which represents twenty-five premier online content companies, consumer groups, and consumer electronics manufacturers who are collaborating to ensure the continued right of Americans to access their choice of lawful Internet-based information, products, and services, including by the attachment of any compatible device to the network. Amazon.com and the rest of the Coalition share the goal of this Subcommittee, the FCC, and the Administration to promote widespread consumer broadband deployment, and we want the companies that provide it to succeed. In my company's case, the Internet is the way our customers reach our store. On behalf of our customers and company, we certainly want to encourage the deployment of consumer broadband access and, just as certainly, do not want to do anything to discourage it.

UNIMPEDED CONNECTIVITY IS THE DEFINING CHARACTERISTIC OF THE INTERNET

Mr. Chairman, unimpeded connectivity is the defining characteristic of the Internet. The Internet and its predecessor network were developed during the Cold War specifically as a means to communicate within the United States after a nuclear attack on our country. In contrast to the contemporary telephone network, which relied on maintaining direct physical connections between points in communication, novel "packet switching" technology allowed Internet communications between two points to be maintained even if intermediate lines were destroyed. In short, not even a nuclear strike could impede the Internet's connectivity.

As the Internet evolved from its military origins to be used primarily for informational, social, and commercial purposes, its unimpeded connectivity took on a new meaning. Almost overnight, American consumers found they were able to obtain for free or purchase any information, products, or services that other people made available on the Internet. Thus, consumer connectivity—*i.e.*, access to Internet content—historically has not been blocked or otherwise impeded by network operators.

CBUI'S SOLE PURPOSE IS TO PRESERVE THE EXTANT UNIMPEDED CONNECTIVITY

Mr. Chairman, the Coalition's sole purpose is to preserve the unimpeded connectivity of the Internet. We believe Americans deserve to retain their longstanding ability to obtain for free or purchase any lawful information, products, or services that other people make available on the Internet and to use compliant devices. We do not believe that network operators with market power should be permitted to impede connectivity for any reason other than routine network management. For example, we believe that broadband service providers with market power should not be permitted, other than for purely technical or legal reasons, to block or impair access to Websites that espouse unpopular political ideas or that sell products in competition with entities that might want to pay network operators to block or otherwise interfere with such access.

Although it may be self-evident, the issue of the unimpeded access that the Coalition seeks to preserve is distinct from the "open access" matter that has been under consideration by policymakers for several years. The open access question is whether and how broadband service providers should be required to allow unaffiliated ISPs access to broadband network infrastructure. Some members of the Coalition are strong advocates of open access for ISPs, while other members oppose it. Like some other members, including Amazon.com, the Coalition itself has no position on the matter, has not lobbied on it, and is not here to testify about it.

Rather, the Coalition has asked the FCC to adopt specific safeguards so that unimpeded consumer connectivity to the Internet is maintained as American households increasingly rely on broadband connections. We have made this request in the context of the Commission's more expansive consideration of the regulatory status of consumer broadband, particularly offered by cable modem and DSL service providers. It bears mentioning what we are not suggesting. For example, we certainly are not suggesting that broadband network operators be subject to extensive, common carrier-style regulation with, for example, entry/exit rules, universal service obligations, rate regulation, *et cetera.* To the contrary, the Coalition merely seeks a narrow rule under existing FCC authority that would ensure that consumer expectations from the narrowband access world would carry forward to the broadband era by barring impairments based on criteria such as content type or source, yet permit differential pricing or other restrictions based on purely capacity-related network management considerations. Please allow me to explain.

Contrary to some misinformation about what the Coalition seeks, we firmly believe that broadband service providers have legitimate reasons to seek to manage demands on their network infrastructure by even a small number of users. Such high-bandwidth users impose significant investment and maintenance costs on service providers and, in the view of the Coalition, should be charged accordingly. Why

should one customer who sends only a few emails a week be charged as much as someone who watches Internet-delivered high definition videos all day long? Thus, we believe broadband service providers should be allowed to charge their customers on the basis of how many bits they receive or transmit over a given period so that they may manage their networks in a technically efficient manner. One way would be to offer tiers of service—*e.g.*, "Gold, Silver, and Bronze"—based on bits transmitted per month. The expensive Gold level service might provide unlimited bandwidth, while the less expensive Silver and Bronze levels would allow only limited monthly uploads or downloads. Once a consumer signs up for a particular level of service, however, she should be able to use it as she sees fit; network operators should not, within clearly defined bandwidth limits, be able to impair a consumer's access to particular information, products or services.

Moreover, current service provider practices, like making promotional arrangements with third parties for advantageously positioned banner ads or links on the initial, or "start-up" page would be permitted to continue. The intent of the FCC rule we seek would not be to prohibit these or similar reasonable private contractual arrangements but, rather, to ensure unimpeded consumer access. And, of course, the Coalition certainly has no problem with—and greatly appreciates—broadband service providers' efforts to prevent unlawful conduct on their networks.

THERE ARE THREE KEY REASONS TO FEAR IMPEDIMENTS TO BROADBAND CONSUMER ACCESS

Mr. Chairman, there are three key reasons the Coalition fears impediments to broadband consumer access. The providers of broadband service have technical opportunities, economic incentives, and marketplace advantages unavailable to narrowband carriers and Internet service providers. And the vigorous protestations of broadband service providers against any non-impairment rule, coupled with their complete refusal to foreswear discriminatory impairment practices, make the Coalition deeply concerned that these service providers actually plan to impair consumer access in the ways we fear.

Technical Opportunities. Broadband consumer access is completely digital and, thus, as the FCC already has determined, service providers can impair connectivity in ways that were virtually impossible in the narrowband, analog dial-up world. The most obvious impairment is blocking access to certain information, products, and services. For instance, a consumer attempting to reach the website for Joe's Pizza might find access blocked or impaired by a broadband service provider that has a contract or other business relationship with David's Pizza, a competitor to Joe's. Other likely impairments include the insertion of "pop-up" advertisements or slower delivery rates based on a consumer's intended type or source of information: A consumer, while accessing an online MP3 file, for example, could be deluged with pop-up advertisements from competing online music sources or could find the download to be particularly slow, merely because she was not pulling the content from a source that had a business relationship with her broadband service provider. As the *Washington Post* analogized, "[i]magine the outcry if a local phone company started preventing customers from calling Lands' End to place an order and redirected their calls to L.L. Bean, which had paid the phone company to be the exclusive purveyor of down jackets to its customers."

In addition to these commercial impairment concerns, of course, there are serious free speech problems with allowing network operators to block or filter, at their whim, access to political, religious, or other material on the Internet. It is not hard to imagine, for example, how a service provider might be pressured to obstruct access to sources of "hate speech" or information about a particular religious or political viewpoint, regardless of whether their individual subscribers want access to that content but, of course, consumer-controlled filters are not problematic.

In sum, as the FCC itself has said, "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."

Economic Incentives. Broadband service providers, especially those that are vertically integrated, also have clear economic incentives to impair consumer access to certain Internet-based information, products, and services. The economic incentive is obvious when the service providers have collateral businesses in competition with other Internet-based enterprises. A broadband service provider that also holds the rights to audio or video products, for example, likely would seek to discourage its customers from accessing the audio or video products of a separate company. The unaffiliated content could be blocked, slowed, or deluged with advertisements for affiliated content. But broadband service providers need not have an ownership interest in a collateral business to have an economic incentive to impair consumer

connectivity: third parties can be expected to contract with these service providers to introduce impairments designed to hurt their competitors. David's Pizza would gladly pay a network operator to impede access to the Joe's Pizza website.

Market Power. For the next several years, while broadband service providers have market power, competitive forces will not be able to check their technical opportunities and economic incentives to impair consumer access to various Internet-based information, products, and services. Put another way, absent regulatory intervention, consumers will have no choice but to accept such impairments until true competition emerges. Currently, two-thirds of U.S. households have access to only one broadband provider or none at all. And, yet, as everyone who has observed the evolution of the wireless industry will recall, even two service providers in an area do not produce true competition, particularly when the friction costs of switching between them makes reconsidering a prior choice difficult and expensive. Yet the number of households with three or more broadband service providers is miniscule. The Coalition anticipates, of course, that the market eventually will become truly competitive. But it simply is not competitive now.

The fact that broadband service providers are vigorously fighting against even a very narrowly tailored prohibition of impairments almost certainly means that they fully intend to impair consumer access. Indeed, the frequent allegation by some broadband network operators that such a regulatory prohibition would hurt investment makes sense only if these service providers count on profiting from impairments. If, as the broadband service providers claim, they are not currently impairing consumer access, and they have no plans to do so in the future, then why do they so strenuously oppose a rule that bans such impairments?

The Coalition is aware of current, albeit modest, impairments of consumer access, and also has spotted strong indications that broadband service providers are poised to exercise their market power to impair at will. Several cable operators recently had terms in their subscriber agreements that explicitly banned "virtual private networks," which are merely software arrangements that establish secure communications among groups of network users, yet place no special burdens on the underlying broadband network. When Coalition members and others showed these terms to the FCC, the cable operators hastily modified their subscriber agreements in a way that concealed the prohibition on VPNs, yet reserved the right to ban them at any point in the future. We cannot help but conclude that these operators merely are trying to mask their intentions while the Commission evaluates the regulatory status of broadband.

Equally significantly, cable operators say they could block access to gaming sites. But this cannot be for the reason that gaming sites are more bandwidth-intensive; they simply are not. Perhaps it is only because so-called "gamers" greatly value that capability and could be forced to pay extra, even though they use no additional bandwidth. Lastly, cable operators have said that consumers cannot attach a device unless it meets with the operators' approval, regardless of what industry-wide approvals the device manufacturer may have. Imagine someone who wants to make a telephone having to obtain permission from each Verizon, BellSouth, SBC, Qwest, Alltel, and a few hundred other telephone companies. That has been unthinkable since the mid-1970s; yet, absent FCC action, consumers who want to buy devices in the cable broadband world will be at the mercy of their network operators.

The cable industry has dismissively characterized the Coalition-requested FCC safeguard as "a solution in search of a problem" but, for the foregoing reasons, the problem is evident; no search is necessary.

WIDESPREAD CURRENT PROBLEMS ARE NOT A NECESSARY PRECONDITION FOR FCC ACTION

But even if there were no current problems, or if current problems were deemed too uncommon to matter, the Coalition believes that widespread current problems are not a necessary precondition for FCC action. To the contrary, the FCC, by its very nature, is a forward-looking regulatory agency that is responsible not just for evaluating past and current conditions but also for predicting future circumstances and acting in anticipation.

Notwithstanding its professed philosophical opposition to anticipatory regulation, the cable industry itself has on many occasions sought regulation to prevent purely prospective harms. For example, the industry asked Congress to ban telephone companies from entering the cable market because it feared that, in the future, the telcos would attempt to leverage their market power to cable's detriment. Later, and again because it anticipated harms from telephone companies, the cable industry successfully lobbied the FCC to adopt safeguards requiring telcos to provide competitors access to basic services on a nondiscriminatory basis. Just as the cable in-

dustry often has requested and received regulatory checks to future use of market power, the Coalition seeks the same protection for broadband consumers.

THE FCC ALREADY HAS THE STATUTORY CHARGE AND AUTHORITY TO BAN IMPAIRMENTS

Mr. Chairman, Congress already has given the FCC the statutory charge and authority to ban impairments of the sort the Coalition apprehends. The mandate to the FCC is clear to ensure that the Internet remains a viable source of information, products, and services for consumers, and that the FCC should adopt policies to promote its widespread use. We simply are urging the Commission to accept the same responsibility in did when it ruled in the seminal *Carterfone* case, which established that consumers can attach devices to the network, and in the *Computer* inquiries, in which it adopted prophylactic rules involving the Bell system because the dominant network operator had opportunities and incentives to discriminate. But, as distinct from these cases, the rule we envision would have a light touch and involves a straightforward declaration of network neutrality, not prescriptive filings that these other rules entailed.

Title I of the Communications Act gives the FCC the authority to promulgate rules to carry out the goals and provisions of the Act in the absence of explicit authority, so long as such rules are reasonably "ancillary" to existing Commission statutory authority and are directed at protecting or promoting a statutory purpose. This authority was validated by the Supreme Court over 30 years ago and many times since.

There are two specific provisions of the Communications Act—Sections 230 and 706, both established in the Telecommunications Act of 1996—that give the FCC the policy direction sufficient to address the discriminatory impairments the Coalition apprehends. Section 230 of the Act makes it "the policy of the United States to promote the continued development of the Internet and other interactive computer services and other interactive media; 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; and to encourage the development of technologies which maximize user control over what information is received by individuals, families, and schools who use the Internet and other interactive computer services."

The Coalition's request that the FCC proscribe impediments to consumer Internet connectivity certainly would "promote the continued development of the Internet," because Internet development is driven largely by the availability to consumers of the content and devices of their choice, and regulatory certainty from the Commission would spur investment by content providers and device manufacturers. Moreover, FCC action would "preserve the vibrant and competitive free market that presently exists for the Internet," because a free market simply cannot exist without the consumer choice that FCC action would safeguard. Conversely, if broadband service providers were permitted to impair consumer access at will, the Commission would have manifestly failed Congress' directive to preserve the current vibrant free market.

Section 706 of the Act requires the FCC 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." The Act defined this advanced telecommunications capability to cover all high-speed services that "enable[ ] users to originate and receive high-quality voice, data, graphics, and video telecommunications."

Clearly, the FCC action proposed by the Coalition would be a "regulating method[ ] that remove[s] barriers to infrastructure investment," because infrastructure includes not only that employed by broadband service providers, but also consumer infrastructure (the devices consumers attach to the network to receive advanced services); and the Internet-based information, products, and services to which the Coalition seeks to preserve consumer access. It is noteworthy that the Commission relied on Section 706 in its 2000 decision extending the rules allowing consumers to install over the air reception devices, finding that consumer access "foster[s] the deployment of advanced telecommunications services." The same undoubtedly is true for broadband: unimpaired consumer access to Internet-based information, products, and services drives the deployment of advanced services.

FCC ACTION IS NEEDED TO PROHIBIT IMPAIRMENTS UNTIL TRUE COMPETITION EMERGES

FCC action is needed to prohibit impairments until true competition emerges. Without such action, and for all of the foregoing reasons, broadband service providers with market power will have the technical opportunities and economic incentives to impair consumer access to Internet-based information, products, and services.

Although perhaps subtle at first, the resulting change to the fundamental character of the Internet would be nothing short of radical and tragic. No longer would Americans be able to obtain for free or purchase all the myriad content they have grown accustomed to receiving at home. The Internet would metamorphose from being the ultimate "pull" medium, in which consumer choice is paramount, to being yet another cable TV-style "push" medium, where gate-keeping service providers decide what content Americans are allowed to obtain. By destroying unimpeded connectivity, the anti-competitive exercise of market power by a handful of broadband service providers would do to the Internet what even a nuclear strike could not.

The Coalition asks, therefore, that Congress urge the Commission in the strongest terms possible to preserve in the broadband era the unimpeded connectivity that has enabled the Internet to flourish to date. More specifically, the FCC should be urged to adopt a narrowly targeted rule that would, until true competition emerges, effectively bar broadband service providers from impeding consumer access to Internet-based information, products, and services. The exception to the rule would be purely capacity-based pricing or restrictions that would require high bandwidth subscribers to pay more in order to compensate service providers for the additional investments necessary to accommodate such use. In other words, discriminatory impairments must be banned, but bit rate-based pricing, such as "gold-silver-bronze" tiering, and other purely network management limitations, should be permitted. Otherwise, unimpaired consumer connectivity will be lost.

CONCLUSION

In conclusion, Mr. Chairman, the defining characteristic of the Internet is unimpeded connectivity. Americans today may obtain online any lawful information, products, or services available or sold on the Internet, without any discriminatory impairment by network operators. The Coalition's sole purpose is to preserve this unimpeded connectivity despite the changing technical, economic, and regulatory circumstances of consumer Internet access. Unfortunately, the Coalition has many reasons to fear for the future of unimpeded connectivity, because providers of broadband consumer access now have the technical opportunities, economic incentives and, most importantly, the market power to impair consumer access to Internet content. For these reasons, we have asked the FCC to use its existing statutory authority to prohibit impairments unrelated to legitimate network management until true broadband access competition emerges. Mr. Chairman, we now ask that you and your subcommittee strongly urge the Commission to adopt this important safeguard to preserve unimpaired consumer connectivity to the Internet.

Mr. UPTON. We appreciate all of your testimony this afternoon.

Mr. Tauke, I want to talk about Verizon's potential investment in broadband and I thought you did a very good job talking about the industry's efforts. But assuming that the broadband piece of the Triennial Review delivers on its promise, what type of investment in broadband can we expect from Verizon in the next 12 to 18 months?

Mr. TAUKE. The head of our telco operations within Verizon has said to analysts on Wall Street that he has a billion dollars ready to start spending on fiber to the home. This would be a change in the direction which Verizon has pursued their broadband up until now where we have essentially focused on the expansion of DSL services and capability. We are now in an aggressive program to bring DSL to 80 percent of our customers by the end of the year. Then we hope that if the rules get in place, that we will be able to launch our fiber to the home or fiber to the premises initiative in early 2004.

But what does it take to start that spending? Essentially two things. One, we need to know what the Triennial Review says and, second, what tells us what we do or don't have to do relating to the unbundling of the network. And second, we need to know what the other rules are. Those would be the rules that would presumably be articulated in the definitional proceeding that is currently at the FCC. If we can get those things done, then the money can start to flow.

Mr. UPTON. What would you say would be the time line at the point that the FCC makes those decisions in terms of when Verizon would announce such capital spending?

Mr. TAUKE. Two quarters from the time the decisions are made until you begin to place the orders, begin the deployment and so on. In order to jump-start the process back in early March after the FCC voted on the Triennial Review we started the process of working with manufacturers so we could set some standards, and other carriers and set some standards for the deployment of fiber. We have been doing what we think we can in order to move this forward. So we have perhaps shortened that a little bit, but it is going to be at least 4, 5 months before anything can move before a decision is made by the Commission.

Mr. UPTON. Your testimony indicated that Verizon had spent $18.5 billion and dropped to $12.5 billion for this. Is that per year?

Mr. TAUKE. Per year.

Mr. UPTON. So you are saying that should we get these decisions from the FCC, you would raise that $12.5 to $13.5 billion, a billion dollar boost within 2 quarters?

Mr. TAUKE. I don't want to say what the capital budget is going to be next year because it depends on a variety of factors. We just don't know what the capital budget will be next year. We do know that if the decision had come earlier this year, there was the money ready to spend in the magnitude of $1 billion over the course of a year into fiber. But presumably, once you start deploying fiber you begin to put more resources into it as time goes by. There would be some of those resources which would come from traditional or previous capital spending that is redirected and hopefully there would be some additional spending that could go into the wireline network. But obviously that depends on a variety of factors.

One of the problems we have right now is that Wall Street makes it very clear they want you to pay down debt rather than to invest in infrastructure. And this is really, in my view at least, a bad thing for the country especially at a time when we need investment and infrastructure, we need more capital spending and we need more jobs.

So one of the things that could help the Wall Street attitude turn around is what the FCC does. If it turns around more rather than less, then we have more flexibility. If the FCC is ambiguous and leaves a lot of uncertainty and Wall Street doesn't think these are good investments, then we have less flexibility to move forward.

Mr. UPTON. Dr. Pepper, that seems to put you a little bit on the hot seat. Mr. Tauke indicated in his statement that this is his fifth time before the subcommittee and as much as he is a good guy and we would like to have him here a number of times in the future, we would like to see the FCC finish the job that is before them.

And as I indicated in my opening statement, we are prepared to have another hearing when Congress returns after Labor Day. And at least from this member's standpoint I would like the decisions to be done, but I wonder if you could tell us where that time line is going to be.

Mr. PEPPER. Well, Mr. Chairman, we hear you loud and clear, and I can tell you that there are no people who would rather see the Triennial Review completed than the people at the FCC. In fact, even on a late Monday afternoon in July, I can tell you that there is staff right now, today, this afternoon back there working to get it done.

Mr. UPTON. Is it going to be done by Labor Day?

Mr. PEPPER. I certainly hope so.

Mr. UPTON. Okay. Mr. Markey.

Mr. MARKEY. Thank you very much. The reality is that if there was no prospect of Tom Tauke having to appear before our committee at all ever in the future, it would reduce dramatically the compensation he would receive from Verizon. So there is a direct correlation between his appearance before us. Paranoia of executives above him in the corporation does determine it to a certain extent.

Let me ask this, Dick Notebaert, remember him, former great CEO of Ameritech. I had this great hearing here in 1994. All the CEOs sat out here from the then seven Bells as they were then seeking to be properly included in the Telecommunications Act. And here is what Dick Notebaert said, which I believe was right on point. He said, quote, the open access and interconnection requirements placed on the telephone companies should be applied to the cable companies. The asymmetrical application of these provisions will frustrate the development of an integrated network of advanced networks. If we are to realize the full potential of the information highway, all telephone and cable networks should be open and unbundled. If some networks are opened and others are closed, we risk creating a tangle of private toll roads and not an open highway. With mandatory interconnection and equal access, customers on one network will be able to reach other networks. Open access requirements also encourages the robust development of niche information providers who can deliver their product with little or no capital investment. As the Nation makes the transition to a system of multiple networks, competition can be safeguarded if all information providers are guaranteed access.

Now that was 1994. Very prescient testimony as we were voting on the Telecommunications Act of 1994, which morphed into the Telecommunications Act of 1996. Now Mr. Tauke and Mr. Sachs, you offer similar services and you both want to be deregulated. And I would like you to speak, however, to Mr. Notebaert's point. Was he totally wrong, Mr. Tauke, back in 1994 in his testimony? And then I will go to you as well, Robert.

Mr. TAUKE. Actually I agree with Notebaert and I agreed with him in 1994 and I agree with him today as I understood what he just said. We believe in open networks. And you could find quotations from me of 3 or 5 years ago suggesting that the FCC should take steps to ensure that there are open networks on the cable side.

What has happened since? Well, what has happened since is we have seen the marketplace at work as we had predicted; that the market would drive companies to have open network facilities because consumers would require that, and that is what we are seeing. The cable side does not have any regulatory requirement though to open their networks, but there has been a steady, strong and steady momentum for open networks on the cable side and they have many more ISPs provided over cable today than they did a few years ago. So we see the momentum in that direction.

Now, I think it is also important to understand that we at least do not think that Title I means closed networks. In our view Title I is a title of the act under which the FCC can set some rules, including some rules for openness, nondiscrimination if they want to. Our recommendation to the FCC is that they lay out some core principles such as open networks, access for all consumers to any part of the Internet, but they don't need today to lay out all of these precise rules.

Mr. MARKEY. Robert, do you agree with Tom that you are going to continue to increase the number of ISPs with no pressure, especially if the Bells no longer had any requirement? That is one of the attractive things increasingly about the Bells is that all the competitors can get on there as well. Maybe the cable industries should have competitors on as a way of making you more attractive as well. So was Dick Notebaert wrong back in 1994?

Mr. SACHS. Mr. Notebaert defines open access as multiple ISPs. Mixed in that was the discussion of access to any information and any content. What has happened is that cable operators have offered choice of ISPs in a number of situations. But I think the market itself is questioning the viability of that model. You have seen Microsoft and AOL, two of the leading ISPs change their business model in the last year where they are focused on providing high quality broadband and unique broadband content rather than simply being an ISP that is reselling cables platform.

The other point I think is worth making, if the regulation that Mr. Notebaert sought of cable in 1994 had been put in place in the 1996 act, we would not have seen the dynamic growth that has occurred in our industry. Today, there are more than 12 million cable modem customers and half that number of DSL. So the fact that cable was not regulated as he suggested and is totally open from a consumer's standpoint, I think does call into question the wisdom of what Mr. Notebaert offered back then.

Mr. MARKEY. Mr. Nelson, could you give me a brief commentary on what you just heard?

Mr. NELSON. I should indicate that this idea of either going, as Mr. Tauke says, to all out regulation or deregulation is not the only choice that Congress or FCC has. There are a number of intermediate steps. We advocate that as the FCC is doing the Triennial Review, you take a market-by-market analysis and in some markets there may be a need to deregulate broadband and others there won't be. But the forbearance provisions that Mr. Jones referred to should be applied. They should not be waived and not be through a sleight of hand ignored by the FCC by this change of classification.

Mr. UPTON. Mr. Tauzin?

Chairman TAUZIN. Thank you, Mr. Chairman. I want to go to Mr. Davidson's testimony and see if anybody disagrees with him on a couple points. Commissioner Davidson pointed out to us that of the four major competing broadband delivery platforms, cable, DSL, satellite and wireless, DSL is the most regulated platform. Anybody disagree with that? I see no hands.

He goes on to say that Economics 101 teaches us that where two products are substitutes for one another, competition is not sustainable, where a substitutable product is subject to asymmetrical regulation. Anybody disagree with that? I see no one disagreeing.

He goes on to point out that if we continue this process of regulating one of the competitors heavily and leaving the others generally unregulated, the competition suffers and therefore consumers suffer. Anybody disagree with that? Anybody? Can we adjourn the hearing?

I mean basically that is what we are talking about. We are talking about a world where broadband service has substitutable products on different platforms, I mean coming from the air, satellites, some coming from wires on the ground, some coming perhaps from terrestrial wireless services. Substitutable products regulated very differently. And if Commissioner Davidson is correct, somebody has a huge advantage here at the expense of the other.

I want to follow up on a thought now. Mr. Markey proposes following Mr. Notebaert's testimony that what we ought to do is regulate them all the same, just regulate them more than the least regulated entity cable. Mr. Dingell and I propose regulating them all less so that there is a deregulated competition going on. I think Commissioner Davidson seems to favor that proposition. Commissioner Nelson said there is something in the middle. There is something in the middle is what we got. All we got is regulating some of the parties to this competition and not others.

Now, Commissioner Nelson, what is the status of competition in Michigan? What percentage of the consumers in Michigan use cable's broadband services as opposed to DSL? Do you have the numbers?

Mr. NELSON. Yes. Approximately in Michigan we have over 400,000 cable modem.

Chairman TAUZIN. 472,405.

Mr. NELSON. Approximately over 120,000——

Chairman TAUZIN. It is 111,182, according the FCC, DSL subscribers, and that includes CLECs. It is 4 to 1. Isn't that approximately correct, 4 to 1 cable over DSL?

Mr. NELSON. Of that DSL, Mr. Chairman, about 90 percent is in the incumbents' hands.

Chairman TAUZIN. I saw you complain about that. But in regards to the overall competition among these different platforms, cable is winning 4 to 1 in Michigan. Does that say to you that Commissioner Davidson has got it right, that cable has a huge advantage over DSL because DSL is the most regulated platform whether it is provided by a CLEC or the ILEC? Does that tell you maybe he has got it right?

Mr. NELSON. Not necessarily.

Chairman TAUZIN. Tell us why not.

Mr. NELSON. Well, first of all, I believe that there are a number of reasons why cable regulation has evolved separately from DSL regulation. You have local franchises involved. Some local franchises authorize more than one competitor and that is the case in many cities in Michigan right now. So you do have that competition amongst cable providers.

Chairman TAUZIN. Do you know how many places in America have two cable companies?

Mr. NELSON. Mr. Sachs may know that. I don't.

Mr. SACHS. Fewer than 5 percent.

Chairman TAUZIN. 95 percent of the cable market is a single provider. And in Michigan they got four times as many subscribers as the telephone providers of broadband. You don't think that is troublesome? You don't think it makes the case if you regulate the dickens out of DSL and you don't regulate cable that consumers, money, investors will flow to the least regulated?

I am at a crossroads. I have tried with Mr. Dingell and I have done this to get Congress to adopt a deregulated approach for equal and fair treatment for good competition and so far we couldn't get the other body to even take it up even though we passed it on the House floor. Is it time for us to say to Bob Sachs and the others, it is time for us to start regulating cable the same way we regulate DSL? Is that the only answer? I would hope not.

Mr. NELSON. I don't think it is the only answer.

Chairman TAUZIN. How can State commissioners, with the exception notably of Commissioner Davidson, take the view that you guys should market to market, keep regulating one provider so differently than another? I will tell you something, Mr. Tauke, the day you really win this battle, the day we don't have this disparity in regulation, this asymmetrical regulatory structure that favors one competitor over the other, the day that is over and you don't have to come back here, you get the biggest golden parachute from Verizon you ever saw. I mean seriously. How long do we keep this game up before we do for the American public what they are entitled to and that is give them the right to choose from similarly regulated entities and let the best service win? Let the one that offers Americans the most open access, the best content, the best interactivities, the faster speeds, the more competent service, the more reliable service, the more dependable service. It is a simple story. As long as you let two stores come into town without the government interfering, one of those stores is going to win over the other because he offered better products at better prices and better attitudes, too. But as long as the government is in the business of saying one store is going to be heavily regulated and the other won't, we can predict what people are going to do, they are going to go to the store that is least regulated and so will investors.

Mr. JONES. I just wanted to point out that our concern—we actually don't have a dog in this fight, which is the mass market residential fight. We are concerned that there is only one store in the business market. And so the worry we have is that whatever may be done on the mass market side to deregulate, if you reclassify the transmission you are going to throw the baby out with the bath water.

Chairman TAUZIN. You mean the business market can't access cable modems and DSL simultaneously?

Mr. JONES. Cable modems don't serve the business market.

Chairman TAUZIN. But cable modems could. In broadband I will bet you the cable industry would love to service a business model along with a residential model. You don't think so?

Mr. JONES. The FCC has already found they don't and they have some severe technical problems in doing so because business customers need upstream capacity, security and reliability that the cable modem network——

Chairman TAUZIN. If I can go back, however, the business market is, however, usually competitive.

Mr. JONES. Not for the end user connection.

Chairman TAUZIN. By all our analysis it is usually competitive. It is the residential consumer market that is suffering right now because the residential consumer in Michigan generally uses cable over DSL because cable is less regulated and cable can afford to make bigger investments and they do a better job than the telephone company, which is so heavily regulated. Is that so complicated?

Mr. JONES. But that is only in the mass market that those statistics are being drawn from.

Chairman TAUZIN. We come out of the mass market, too. I think I used up my time.

Mr. UPTON. Gentleman, Mr. Davis is recognized for 5 minutes.

Mr. DAVIS. Thank you, Mr. Chairman. I willl start with my question to Dr. Pepper.

Is the pending Ninth Circuit decision on classification of cable modem ultimately something the FCC needs to take into account before you reach the conclusions we have been talking about here today?

Mr. PEPPER. We are obviously watching that very carefully. That decision of course, as you know, addresses questions in the cable context and a challenge to our declaratory reliance on the cable side. We are continuing to proceed with our analysis on the wireline broadband proceeding and the definitional issues there because again there are differences between the two. But we are watching the court very carefully as we proceed internally with both proceedings.

Mr. DAVIS. I guess I am still not clear on what you are saying. Is there any reason why the Commission needs to wait for the Ninth Circuit decision before you reach conclusions on this issue?

Mr. PEPPER. Well, on the cable side that is where the challenge has been and the case has been briefed. We are still moving forward continuing to do the analysis internally at the staff level on the wireline side. The Commission does not have a proceeding or a recommendation in front of it to vote on yet and the staff is continuing its analysis while we watch the Ninth Circuit and wait for its decision. We don't know yet when that is going to be.

Mr. DAVIS. Do you intend to wait for the Ninth Circuit decision before the FCC acts then?

Mr. PEPPER. Probably not. Well, it depends upon how quickly they act. But the Ninth Circuit also is—you know, I talked to my

colleagues and they have pointed out that the Ninth Circuit sometimes takes over a year or 2 years to issue its decisions.

Mr. DAVIS. I would like to give Mr. Sachs an opportunity to respond to the points that were raised earlier by Mr. Jones in terms of what we might reasonably assume would be the availability of cable modem service to the types of users he was describing.

Mr. SACHS. Historically cable systems were built to pass residential neighborhoods, not office parks, not downtown businesses. But as our networks are expanding, we are in a position to serve smaller and medium sized businesses. And as the cable modem technology itself is improved so that we can offer usage sensitive and tiered pricing arrangements, increasingly the small business market will be attractive to us.

If I could comment for 1 second on the question of the Ninth Circuit, we would hope that the Commission would not wait for that three-member panel to decide. I think most observers believe that there will be further appeals to the full Ninth Circuit and eventually to the Supreme Court. And normally, where there are ambiguities in statutes and some which would allow different and reasonable interpretations, the Court would defer to the expert agencies. So in this case, we would hope that that would be the outcome in the Ninth Circuit, but certainly that the FCC should not forebear from reaching a decision because there is a case that has two more levels of appeal ahead of it.

Mr. DAVIS. Can you be more specific as to when the changes in cable modem service you just described might be available in the marketplace to some of these end users?

Mr. SACHS. I would be happy to supplement my testimony in writing. So we will talk to our member companies and will give you specific information on that.

Mr. DAVIS. Mr. Jones, any further comment you want to make on this? You are welcome to talk about the availability of this service.

Mr. JONES. Actually I wanted to respond to the notion of cable serving small and medium sized businesses. It is a twofold problem. Problem No. 1 is that cable networks generally were not built to reach the areas where most businesses are located. For example, the FCC concluded in its 2002 broadband report, high speed cable modem service is primarily available to the residential market rather than the business market. Cable networks were originally deployed to provide video programming and other programming services to residences throughout the United States. While some residences are located in areas where there are large and small businesses alike, most businesses were originally and still are not wired for cable services.

So it is not even a question of upgrading the facilities. They are not even there. To the extent that they are there, recent testimony by Cox in Rhode Island illustrates exactly what is going on in these upgrades is that they are selecting very targeted business opportunities and they are by no means ubiquitous. The problem with the facilities that CLECs have is that they need a ubiquitous alternative. If the Title II regulation at least as to the business market is eliminated and they are not able to get those ILEC and user connections to compete in that business market, they will be left with

no reasonably priced, reasonable quality service alternative and they will go out of business and the small business market will suffer greatly. In fact, Joe's Pizza and David's Pizza, mentioned by Mr. Misener earlier, will be paying much higher bills for broadband connections.

Mr. DAVIS. Does anyone else want to comment on this particular point, availability of cable modem services and alternatives?

Mr. TAUKE. Thank you, Mr. Davis. When you look at the broadband market and look at residential customers you see cable as the dominant provider. When you look at the business provider, downtown Washington, it is not cable that is the primary competitor. There are a number of other facilities based providers, some of what are represented by Mr. Jones, but also companies like AT&T and MCI.

My office is on 13th and I. I think that 13th street, 12th street have been dug up at least 10 times over the last 2 years to lay fiber by one company or another. If you go into Manhattan, the competition in the business market is severe. It is, you know, very robust, and lots of facilities based providers.

I just observed—we don't know what the FCC decided in its Triennial Review for sure, but looking at the press release, we know these issues are addressed in the Triennial Review. We believe that if a business, let us say Joe's Pizza, is served by a copper wire, any carrier can come purchase that copper loop, put its DSL on that copper loop and serve the customer. If we replace that copper loop with a fiber loop, then they have the opportunity to build the fiber loop too and therefore we don't expect that we will have to provide that fiber loop to them. However, we may want to provide capacity to them. You don't have to have regulation to do it. We could provide and we want to provide capacity to other carriers on our network. If you are a network provider you want to sell capacity. The question is whether you need a lot of regulation to make that happen. In the wireless world and the long distance you don't have that regulation and you have a robust wholesale business. We think that will happen here, too.

Mr. DAVIS. I assume that you would agree that Joe's Pizza on 13th Street, notwithstanding the road being torn up, has benefited from the type of competition you just described?

Mr. TAUKE. Joe's Pizza is benefiting from facilities based competition.

Mr. DAVIS. And you are suggesting that if you were reclassified to an information service then perhaps the terms under which you make your facilities that these CLECs might not change very much?

Mr. TAUKE. Not to be picky, but to be clear. First, Title I is not just an information service. Title I is where we have private coverage. We have CPE. There are a number of things regulated under Title I. Doesn't mean that it is an information service.

Two is that this issue of whether or not you have to share the network on an unbundled basis is a Triennial Review decision, as we see it, and as we understand what the FCC is saying they are going to say that trumps the definitional issue. So if they decide we have to provide it that way, unbundle it, we are going to have to do that. That issue is in a sense in the Triennial Review.

Now what was your question?

Mr. DAVIS. I think you have made your point. Let me go back to Dr. Pepper. All right, Mr. Chairman, time flies by.

Mr. UPTON. Mr. Shimkus, who deferred with his opening statement, gets an extra 3 minutes.

Mr. SHIMKUS. Thank you, Mr. Chairman. And just before I go on my questions, I would say that Chairman Tauzin did a very good job addressing the State commissioners. And I think it would be incumbent upon all of us to go to the FCC and find out our ratio as far as residential connectivity. I know at home I am on a cable modem service. I was on—I had other services, but that was meeting the needs of mine right now. And I bet you I will find out the same story in the State of Illinois and I look forward to doing that.

Mr. Baker has been sitting there quietly, and I have a couple of questions because it really does tie into all of this debate. I wasn't here when the Telecom Act was written or passed. I am a product of coming afterwards. And when I first got here, trying to figure it out, I always thought that the intent was multiple competition inside the pipes. And evolution is that we hopefully will have multiple pipes providing the competition, hence the number in Michigan of cable over phone service and the like. EarthLink has advocated open access requirements for cable operators and telephone companies. Do you advocate similar government mandate, open access requirements for your electric company associates in the Power Line Communication Association to hopefully roll out the broadband power line.

Mr. BAKER. We have not taken that position.

Mr. SHIMKUS. Why not?

Mr. BAKER. Among other things, power line communications or broadband over power lines, as the FCC calls it, are still in the trial stages. And I know a lot of times when we talk about broadband access, people sort of run to a list of different platforms over which consumers can get Internet access. But in point of fact DSL and cable between them account for over 98 percent of all broadband connections in the United States. And we can talk about satellite and talk about fixed wireless and we can talk about power line communications, but there is a rounding error in terms of a means of providing broadband connections to consumers.

Mr. SHIMKUS. We are not even in the power line yet. There is—you are not in a position to penetrate between the two providers right now, is that correct?

Mr. BAKER. That is correct.

Mr. SHIMKUS. So how long will we be until we broadband power line?

Mr. JONES. It is in the trial stages and hopefully we will see commercial deployment in the next 12 to 18 months. Again we are talking trials while DSL and cable providers are signing up on the order of a million customers a month between the two of them at this point.

Mr. SHIMKUS. Let us say you are available to commercially roll out between 12 and 18 months. Would you rather roll out under an environment where you had to go through the regulatory scheme of the wireline or the unregulated scheme of the cable industry?

Mr. JONES. I would rather we didn't have to deal with these many regulations. We have to distinguish between what sectors in the market are competitive and which are not. Once we get to an environment hopefully where there are three or four broadband pipes that consumers have available to them, then it becomes less crucial to ensure that each of those pipes has—is an open platform because then consumers will have greater choice in who is providing the broadband. But in the situation today where there are essentially two broadband pipes that serve consumers where many consumers have available only one or the other of those two pipes, where the cost of switching between those two pipes, those two platforms is very high because of customer premises equipment costs, because of termination fees, you develop a situation where there are two broadband pipes at best available to most consumers and therefore two broadband providers, and that is a far, far different environment than what has made the Internet so ubiquitous.

Mr. SHIMKUS. Let me ask this question, with all due respect to the great testimony we have. I am an old—I keep saying in this committee I am an old instrument with the acronym of KISS, keep it simple, and it is not politically correct to tell you what the last S is. Keep it simple.

I think it is a pretty simple answer. If you want to roll out a competitive market product, and you have got two competitors and one is regulated and one is not, I would think I would want to enter the market as an unregulated entity. Does anyone disagree with that? You disagree?

Mr. BAKER. No, but I am saying I am not entering their market.

Mr. SHIMKUS. The point is does not EarthLink, aren't you a member of the Power Line Communications Association broadband?

Mr. BAKER. Yes, we are.

Mr. SHIMKUS. Isn't it one of the main purposes to promote broadband power line deployment?

Mr. BAKER. Yes.

Mr. SHIMKUS. If you want to enter the broadband market, and you are going to do it through the electrical wires and you are going to compete with the telephone and the cable, would you rather do that unregulated or regulated?

Mr. BAKER. I would rather do it unregulated.

Mr. SHIMKUS. I yield back my time.

Mr. UPTON. The gentleman from New York, Mr. Engel.

Mr. ENGEL. Thank you. Thank you, Mr. Chairman. My good friend from Massachusetts was—gave us a quote before, and I wasn't on the committee in 1994 but it just strikes me that the one thing missing from that quote is when you add in the profit motive, you know, we—you run smack into the free-rider problems. Why spend billions of dollars for investment when you can rent something for a lot cheaper? I am wondering if Mr. Sachs would like to comment on that.

Mr. SACHS. Our companies, since 1996, have invested more than $75 billion of private risk capital in upgrading networks for multiple purposes, to meet satellite competition, to offer new

broadband services, enter markets which were unproven with respect to public demand for high-speed data services.

It is understandable to me why EarthLink, which has not made this investment, would want the government to allocate a portion of Cable's pipe to EarthLink. The reality is that EarthLink has been able to negotiate business arrangements with the three largest companies in our industry. With Charter Communications going back 5 years, with AT&T, the predecessor to Comcast in several markets, and by virtue of the consent decree that AOL Time Warner had entered into in a number of Time Warner markets.

It is perfectly understandable why EarthLink would want the government to intervene on its behalf in private business negotiations. But to the entrepreneur who is looking at investing money, taking risk, it is unacceptable to suggest that somebody else, who is not willing to take that same risk, should have all the benefits of that investment.

Mr. ENGEL. Thank you. Mr. Tauke, can you cite—you mentioned several reasons why you believe things should be deregulated. Can you cite a few specific regulations that Verizon has to follow that cable does not have to follow when providing high speed services?

Mr. TAUKE. Well, one of them that we are just talking about was nondiscriminatory access to all Internet service providers. That is a requirement that we have. We have requirements relating to the structure of our business under the Computer Inquiry 3 Rules, which we are required to live with that the cable industry does not have to live with. We, at the current time, have unbundling requirements for our network that the cable does not have for its network.

So there are a lot of, whole host of telephony regulations that are very severe that apply to our broadband activity today.

Mr. ENGEL. But actually in both your testimonies, and I read both Mr. Sachs' and Mr. Tauke's testimonies, you are actually though, there is a convergence of interests here. I want to just say that I support the Chairman's remarks. I was, I am a strong supporter of Tauzin-Dingell.

When I entered Congress, I thought regulation was the way to go. The more I am on this committee, I have a 180-degree opposite feeling about it. And I do feel that competition actually plays out. So it seems to me that there is a convergence of interests here.

I was interested in your testimony, Mr. Tauke. I am quoting between 2000 and 2002 over annual investment by wireline telecommunication carriers, including Verizon, declined from $104 billion to $42 billion, spending on new equipment down 19 percent. So on and so forth. I am wondering if you could expand on the reasons for that. You did talk a little bit about it, but I am wondering if you could do that.

You also say in your testimony Wall Street is skeptical of increasing capital spending in telecommunications, and instead is awarding cutbacks in investment. You mentioned that in response to a question. In the telecommunications industry, I am quoting from you, a significant factor is investors believe that the regulatory rules simply make it nearly impossible to realize any return from investments in new technologies and services. We need to re-

verse these trends for the good of the economy, the industry and consumers.

I just want to give you a chance to expand on that a little bit.

Mr. TAUKE. Thank you, Mr. Engel.

First, I think you have to understand that in our industry today, we are in a transition in the wireline side of the industry. The voice traditional, voice telephony over the traditional wireline network is a rapidly shrinking business. So you have to adjust and make new investments to provide new capabilities and new services, new capabilities in the infrastructure, and new services to the consumers. Our problem, at the moment, is that that adjustment is being stymied by regulation because we don't know what the rules are. And as these rules oppress your ability to make this investment, it means reduced jobs and economic harm, but it also means the consumers aren't getting the benefits of this transition to a new network and the services it can provide.

It is very hard—these are risky investments. I mean everybody will tell you this is a risky marketplace we are entering into. It is a new, undeveloped market. It is not a mature market. So as a result, it is, in our view, wrong for the government to have the rules that were written for a mature, highly developed market apply to this new market that we have new investment in and which is still very uncertain. And when you do apply those kinds of rules, you really reduce the possibility of getting investment in that new market and in that new infrastructure.

So I guess our bottom line is we need clarity of what the rules are. The rules should be the light regulatory touch until you see how this market develops.

Mr. ENGEL. Thank you. I believe my time is up.

Mr. UPTON. Time is expired. Mr. Stearns.

Mr. STEARNS. Thank you, Mr. Chairman.

First of all, let me welcome and thank Mr. Davidson for coming as Florida Public Service Commission. We welcome you here; appreciate your testimony.

I was reading on your opening statement where you mentioned that a Wall Street Journal article said that telecom investment is down 75 percent since the year 2000. There have been more than 1,000 telecom bankruptcies, the market has witnessed a 9-year low in venture capital investments. And there is a 28-year low in initial public offerings. This is as of July 1, 2003.

Let me ask you, you have mentioned the roles of States in broadband deployment in your opinion, how have the various State laws affected broadband deployment? I guess both good and bad. And maybe have Mr. Nelson talk about it too, because, you know, we have all indicated here, Mr. Tauzin has made the point eloquently, that this regulatory uncertainty has created a desire in the minds' of investors to hold off. And so just in tune with that, what do you think that the States' rights role should be?

Mr. DAVIDSON. Thank you, Congressman.

As I set forth in my testimony, I think the States do have a fundamental role here on the supply side, on the demand side, and on removing any State-specific, city-specific, municipality-specific barriers to deployment of new networks.

A key problem, in my opinion, is that companies in all the different modes face this patchwork of different State rules, which from a planning standpoint is hard to deal with. It is hard to calculate how do we measure this investment risk when we may face a good situation in Florida, and I think companies do, and we may not face the same type of situation in another State.

So States certainly impact the planning process. I think——

Mr. STEARNS. You don't think they would create regulatory uncertainty, this States' right regulation that you are talking about?

Mr. DAVIDSON. Oh, my view is that a uniform national policy is much better than a patchwork of different State policies. I think State-by-State regulations would create additional regulatory and investment risk.

Mr. STEARNS. Okay. Mr. Nelson do you have—want to comment?

Mr. NELSON. Thank you, Congressman. I believe we can have both. I think State initiatives, like the ones I described for Michigan, where we have financial incentives that are made available to not only providers but users of broadband, a very light-handed regulatory approach will work very well in Michigan. In addition, tearing down the right-of-way access barriers, as we have done in Michigan, has been heralded by TechNet as a very significant step.

But at the same time, I think you could look at regulation in some respects, some States have been very successful in using Section 251 of the Federal Act to deploy line sharing. Line sharing is somewhat up in the air now because of the FCC Triennial Review order and court review, but it has worked very well in many States. And they can use regulation or more light-handed regulation, as we do in Michigan, to promote broadband, and both work.

I think you can have national guidelines, but also the laboratories of democracy in each State should be able to deploy broadband as they see fit.

Mr. STEARNS. Dr. Pepper, let me have you elaborate on the record on why you believe that regulating broadband services, such as Title II common carrier services, would undermine investments in such services and the facilities used to provide such services. I guess the question is, what is it about, this Title II regulation that serves as a disincentive to investment? Maybe you could give us a capsuled version.

Mr. PEPPER. All regulations have cost. And we are very aware of that. And you know, the approach that we are taking is that—you know, the presumption we have a nascent market. The market is growing very rapidly. We have firms entering these markets. And the presumption is that we should wait and see how the market develops before imposing these costs. And frankly, if problems develop, we have the ability to address those problems. But at the moment, what we are seeing is entry—as Chairman Tauzin pointed out—nationwide happens to be three to two. For every three cable modem service customers, there are only two DSL customers. So we see this as a market that is growing. We see this as a market that, in fact, is one that we believe we should not impose burdensome costly regulations that are going to create disincentives to investment, unless there is the demonstrable, specific, identifiable problem. And at the moment what we see, frankly, is, you know, our competitors moving into the market to compete.

Mr. STEARNS. Thank you, Mr. Chairman.

Mr. UPTON. Mr. Walden.

Mr. WALDEN. Thank you, Mr. Chairman. My apologies for being late. I took the fastest plane that would cross the country and got here as soon as I could.

Dr. Pepper, I have a question for you and hopefully you will be able to address this. I was with a group of radio engineers a while back who expressed some real concern about whether or not the idea of putting broadband on power lines, basically, has been well-vetted from a technical standpoint as it relates to interference on some bands. Is the Commission looking at that? Have you looked at that? What have you found?

Mr. PEPPER. Yes, Congressman. We actually have a proceeding looking specifically at that question at the moment. There are issues having to do with radio emissions from power lines, but one of the things that we have been, you know, talking to the power line industry about is how to mitigate noise emissions. There also were questions about, frankly, how far those emissions go from the wires themselves, especially on the high tension wires. The falloff appears to be very, very severe. So it drops off very quickly. But those are precisely the kind of questions that we currently are looking at in our power-line proceeding.

Mr. WALDEN. Are you also looking at the noise that is generated on the AM band, AM broadcast band?

Mr. PEPPER. All of those are related, those questions, yes.

Mr. WALDEN. I have not had time to get through all the testimony in the little time I have been here, I do have one question, I represent a very, very rural district. I would be curious to hear from the various panel members who are in the business of deploying broadband or access to broadband, what do you do to get broadband into, I am talking, very remote areas? Or are these communities going to be left off the latest highway?

Maybe we start with the FCC. From your standpoint, what, in your rulings, are going to guarantee folks in any district aren't going to be left behind again?

Mr. PEPPER. Congressman, under Section 706 that others have referred to earlier this afternoon, we periodically look at the deployment of broadband, especially in rural areas. And so we are monitoring this very carefully. What we are finding are several things.

One is that the—some of the smallest cooperative, cooperative telephone companies, the little co-ops, the littlest of the little, they indeed are making the investments in broadband in many places, but not everywhere. We also recently have had a joint event with the Rural Utility Service at the Department of Agriculture.

Of course, Congress has made, I think, it is $1.4 billion available for rural—for loans in rural America for broadband specifically. We are working very closely with the Department of Agriculture.

We are working on issues and proceedings that will make more spectrum available because, frankly, getting wires out to some of the farmhouses and the ranches, that is tough. Using wireless technologies, we believe actually may be the answer for the least dense areas. And so we, in fact, are working with not only companies that have licenses to provide wireless services, but also with the com-

munity that they call WISPs or Wireless Internet Service Providers, many of whom are using some of the wireless devices like Wi-Fi. This getting broadband out to rural America is very very important. It is very high on our agenda.

Mr. WALDEN. Anyone else?

Mr. NELSON. Yes, Congressman. I believe the National Telecommunications Cooperative has filed comments in the docket on what we are talking about, that urge that the Commission not change its designation of broadband wireline services to information services. Because it would, in their view, be detrimental to rollout. And in rural areas, they indicate that one of these issues involves the authority of the States to authorize new entrants. This would be jeopardized if it was deemed an information service.

Mr. WALDEN. Mr. Tauke.

Mr. TAUKE. I think it is interesting to note that in rural areas that are served by the thousand or so small independent telephone companies, that actually the broadband rollout in those areas is very rapid. And one of the reasons—I believe there are several reasons, but one of the reasons is they operate under a very different regulatory regime. So they have the ability to make this transition in networks more easily than companies that are highly regulated. They also have support, financial support, low-interest loans and so on that help with that.

Second observation I would make is that we don't know exactly how technology is going to develop, wireless, Wi-Fi, maybe power lines, various other things. I think in a couple of years it would be appropriate to make an assessment, as this market develops, whether or not there is a problem in rolling out in rural areas, because there may be some need for additional assistance. I just don't think we know yet.

Mr. SACHS. Congressman, if I could comment briefly. Cable today has about 97 percent of the homes in America and more than 80 percent of those are upgraded for broadband today. And we also represent smaller cable operators. And there are companies like Midcontinent in the Dakotas and Sjoberg Cable in Minnesota that are providing service to communities with as few as 100 people today.

It may seem counterintuitive, but with the higher degree of satellite penetration in these smaller communities, operators are looking to upgrade, plant and extend it as deeply as possible, because then it creates the potential not only to offer video services, which alone were uneconomical, but to overlay that with cable modem service and potentially voice over IP may well change the economics there. I think we will know the outcome there within the next several years.

Mr. JONES. Congressman, I wanted to point out to the extent that these buildouts actually don't take place and regulators need to rely on universal service subsidies, if the transmission component of incumbent broadband is reclassified, universal service subsidies will not be available. It will no longer apply to these services because they will no longer be telecommunications services, which are the subsidized services in the Act, they will be telecommunications. Those are not subject to the subsidy.

And the Supreme Court has held that the FCC lacks the authority to fix that problem. When you change the categories, you are stuck with them. And Title I can't help you out.

The other thing, I think, to be said about this is, to the extent you have rural carriers that are not RBOCs, that are widely deploying these facilities, they are benefiting from some cost allocation programs, NECA pooling and so forth, that currently apply that will also go away if you reclassify these services. So not only do the possible subsidies of tomorrow disappear, but the subsides of today that are allowing those rural carriers to deploy their networks will also go away.

Mr. WALDEN. Thank you, Mr. Chairman.

Mr. UPTON. Thank you. I know members have just a couple more questions. So let me just start, I want to follow up on one of Mr. Engel's questions to Mr. Tauke with regard to the regulations that you all comply with that the cable company does not. You cited a number of them. Do you know what the cost is to Verizon?

Mr. TAUKE. No, Mr. Chairman, I am afraid I can't give you a sense of the cost. Essentially, while cable is able to do business with business-to-business arrangements with all of the other players in the Internet, we file tariffs, and we have to have everything approved through the FCC process, and so it is—it costs in terms of your inability to enter the market, capture the market, compete effectively, what—so that is the big cost. The actual cost of compliance, I am sure is significant, but it pales in comparison to the lost opportunity to fully engage in the market.

Mr. UPTON. In Commissioner Davidson's testimony, he says this: An industry that faces 50 potentially divergent jurisdictional approaches to broadband will have less of an incentive to invest than would an industry that faces a more uniform deregulatory national policy. Does anyone want to comment on that other than Mr. Davidson? Agree, disagree? No one disagrees? Mr. Markey.

Mr. MARKEY. Thank you, Mr. Chairman.

One of the disadvantages of having served on this subcommittee for 27 years is that I am too well aware of the high-hypocrisy coefficient which exists in much of the testimony that we hear which raises what we call the risibility coefficient, to use a Tony Blair word, in terms of my reaction to that testimony. And I remember the cable industry, and you should have been here Eliot, they were—it was kind it was compelling. It was a tear-stained bit of testimony back here in 1978 how this nascent cable industry needed to have nondiscriminatory access to all the telephone poles of another industry because they weren't going to build their own telephone poles. And not only did they want nondiscriminatory access, they wanted preferential rates. They wanted the telephone company to subsidize them, the cable industry.

And I being just a knee-jerk liberal that I am, I went for this cable industry. They needed help. They were kind of like the Amazon.com for the EarthLink of its time. They needed some help in the nascent so they could provide new services. So I went along with it. You might notice, to this day, there still is no cable pole going down the street. And that is all right, you know, because they didn't want to really buildup.

And as many of the witnesses here know, I could go down a long litany list of other—we will call them asymmetries which both industries enjoy right now. If I did, I would consume all of the time that I have and it would not leave time for a question. But nonetheless, I just would want to point that out. And the fact that the cable industry is unregulated does lead to the 40 percent cashflow, which its industry does in fact enjoy, which no other industry in America can really quite compete with, and much of that is because they have unregulated rates, which does lead to an awful lot of private risk capital money to go to a business like that. But because it is totally unregulated with no real competitors, as someone pointed out, that only 5 percent of America really has competitors. That does lead to an awful of lot of risk capital going to a nonrisky investment, you know, because risk capital doesn't like risk. That is really the paradox and almost Orwellian way they try to describe themselves. That is not who venture capitalists are. They don't like the "ad" in the "venture", if you know what I mean. So they don't really go there. And the cable industry has become a very attractive, unregulated monopoly in almost every community in America. But I just put that in as a historical, a little observation right now.

So I would like to go to kind of the Amazon.com and the EarthLink, you know, kind of what happened after the Telephone Act passed players in the marketplace today so that perhaps you could comment on Mr. Notebaert's observations back in 1994 on the equal access and interconnection and nondiscrimination and these advance networks, and what it means to your companies, and hundreds of other companies like your companies, who from the perspective of the concern that most people seem to have here that we are looking for more companies and more growth, you are the growth. We are still going to have the Bells, and we are still going to have the cable companies, but you are the new name, so could you give us your comments Mr. Misener?

Mr. MISENER. Thank you, Mr. Markey, very much.

In some senses, it is less important what it means to our company as it does what it means to our customers. We really want our customers, both existing and future, to be able to get access to our site in an unimpeded fashion. If they had many choices of service providers, network operators, in between them and us, it would fine for them to choose the one that they thought best. But to the extent there is little, if any, competition in that pipe between them and us, they deserve to have this unfettered access to whatever content, be it ours or eBay's or anybody else's on line. I think there is an important subtlety that has been discussed here just momentarily, and it has to do with this unimpaired access idea. In reference to cable broadband service providers, Mr. Sachs in his testimony said, "All offer unfettered access to Internet content." We disagree and for reasons that I explained in my written testimony, there are some examples. But notice what he didn't say. He did not say that cable will continue to offer unfettered access. In fact, he has never said that cable will continue to offer this unfettered access. It seems to me Mr. Markey——

Mr. MARKEY. Can we ask him right now? Will you offer unfettered access to competitors in the future, Mr. Sachs?

Mr. SACHS. We represent a large number of companies, large and small. And I have not seen any indication or any evidence whatsoever that these companies have either in the past not offered unfettered access or have any intention in the future of not offering——

Mr. MARKEY. So can you make that promise for the future so that Mr. Misener can get a good night's sleep tonight?

Mr. SACHS. I would make a representation to you if I had, you know, my—all my companies, you know, before me here, but I was going to say, in all the discussions that I have been privy to, in all the explanations of their business plans, there is no indication whatsoever of any desire to limit access. It is a little hard to make a blanket representation for an industry that has undergone consolidation and change with numerous players as to every company's business practices. But there is nothing——

Mr. MARKEY. But, see, that is the point, though, from the perspective of the entrepreneurial information service company that you are creating an environment here where you are leaving this hearing telling them and potential risk capital investors and this is risky to go with these guys because you are saying, I am not sure I can promise in the future that they will be—so I would go with you, if I was a risk—if I was a venture capitalist. I wouldn't go with them because they don't—they can't be guaranteed.

Mr. SACHS. This is no different than with Amazon.com which is a great service that we all use, and when you go to that site, and when you visit that site, you sign up for their user agreement and their privacy policies, and they reserve the right to change them without notice to you. I don't think that it is realistic for any association or company to come before you and say, "for the future, forever, there will be no change whatsoever in our business plans, which may include legitimate business practices that will change over time depending on how business models change." But what I can say to you, and we have been in this business now for 7 years, we serve more than 12 million customers, we are available across the country, and neither Amazon nor any other members of this Microsoft-led coalition can provide you with any evidence whatsoever of access.

Mr. MARKEY. The problem, Mr. Sachs, is right now these companies have guaranteed access to all the Bell Companies that Mr. Tauke represents, and they don't have guaranteed access to you. But at least they know they can go that way, which kind of does put a pressure on you. If they are over here on this other, and there is only two pipelines going into homes, and they are on this other pipeline it gives you a lot of pressure, it seems to me, to carry them. So if you are saying you are not going to promise in the future that you are going to carry them, even if Mr. Tauke and his companies are no longer required to carry them, that is going to create an awful lot of investment uncertainty for hundreds, thousands of companies like EarthLink and Amazon and other companies that did create most of the job growth in the 1990's. The job growth wasn't created by the telephone or cable industry. They were created by these other companies whose names' nobody knew before the 1996 Act passed.

I will let Mr. Baker make a point.

Mr. BAKER. I agree with a lot of what Mr. Misener said, and let me point out that EarthLink is a member of the Innovators. But as far as ensuring that unfettered access, you know we view that there are really two ways you can do that. I am speaking as an individual company right now. No. 1, you can say the FCC can provide a rule on Internet providers, namely those associated with the telecoms or cable companies, that they not discriminate. The other is to lay the groundwork so customers can choose among multiple Internet providers on any given platform, and then that is a market-based solution which is actually less regulatory. And then if you know, one platform or one provider, you know, doesn't—you know, blocks access to a certain site, then the customer is able to vote with their feet and go to a different provider.

Mr. MARKEY. Mr. Misener, 10 seconds to respond.

Mr. MISENER. It is really consumer access to all the myriad of content on the Internet. Mr. Sachs's analogy to our privacy policy not only is incorrect, but it is inappropriate because Amazon has literally thousands, if not tens of thousands, of competitors. If a consumer doesn't like what we offer in terms of service, product, price, whatever, they have elsewhere to go. They are captive to the single monopolistic service provider that he represents.

Mr. MARKEY. Thank you.

Mr. UPTON. Mr. Tauke, did you want to say one thing?

Mr. TAUKE. Just would encourage the committee, as you are thinking about this issue, to recognize that when you speak of the customer experience on the Internet, there are various layers of companies who are involved in that customer experience. You have transport providers, you have application software people, you have operating systems people like the Microsoft windows, you have firewall people, you have the ISPs and the content providers. Right now where—I think it would be fair to say that there is as much concern about Microsoft, for example, doing something with software to restrict access. Yet, I haven't heard anybody suggesting that there be regulation of Microsoft. Certainly, there is concern that an AOL or an EarthLink, one of the significant ISP providers, will say to Amazon.com, we don't like Amazon.com, we prefer Barnes and Noble, and there is no regulation. Never has been anything to prevent them from doing that kind of thing.

I guess that if you start going down the path of ensuring that through regulations that the customer is going to have unfettered access, you are going to start regulating a whole lot of companies. And the question really that you face is a classic one: Do you peremptorily regulate before you see how this market develops, or do you allow the market to develop and then see if there is regulation needed?

And I would suggest to you, Mr. Markey, when you were the distinguished chairman of this committee, that you led the deregulation of wireless in part because you had faith in the way that market will develop. I think it has been a boon for the wireless industry. It seems to me that the same thing can happen here. That doesn't mean you have to give up the authority to do something down the road if any of these levels, the transport level, the ISP level, the software levels in any of them are doing things that are harmful to consumers.

Mr. MARKEY. If I may just add, the reason that I did support the deregulation was we were adding in 1993, a third, fourth, fifth, sixth carrier in each marketplace. But what we found that was when there were only two, they stayed at analog and it was still 60 cents a minute. Once we went to digital the other five got in, it went down to 10 cents a minute and lower. So two, I have found, in every single industry, it just doesn't quite get that level of dynamic because you have two highways, but you have got hundreds of stores. So you can move over to Amazon.com, to Barnes and Noble, but there are plenty of other stores as well, but there are only two highways. The shoppers, the consumers should be king. They should be able to go anywhere. That is the—Mr. Sachs.

Mr. SACHS. I was going to say, and Mr. Tauke said this on a panel we were on recently, that if any of our customers found their access to any Website in any way restricted, his company would seize that opportunity. We are advertising lightening-fast access to any content of your choice. And for our companies to lose that contract with their customers because of impeding access to one or another Website, just goes against any good business sense.

Mr. UPTON. Mr. Engel.

Mr. ENGEL. Well, after 27 years on the committee, I almost feel like I want to ask Mr. Markey a question. But I will do that in private. I just come from the belief that once the genie is out of the bottle, that it is very difficult, if not impossible, to put it back in again, in terms of regulation. The bottom line, and I think all of us feel the same way regardless of where we come down on the issue, is we want to see competition, and we want the consumers to have the best break. The question is how do we get it?

I think Mr. Tauke said it all when he talked about preventing investment. To me that is bad for the consumers because if we don't have expansions, consumers won't get what they want. I want to, since I feel Mr. Sachs has kind of been beat up on at the end, I read some of the testimony that Mr. Tauke had given earlier, I wanted just, Mr. Sachs, to read some of yours and give you a chance to expand on it. You say promoting competition rather than regulating competitors should be the cornerstone of U.S. broadband policy. You also in line with that say, which brings me to my final point, to the extent the FCC believes that cable modem and DSL services should be subject to some version of equivalent regulation, it should adopt a regulatory parity, that is, the Commission should remove regulatory constraints, not add new ones.

I thought you might want to comment on that. You have said it.

Mr. SACHS. First, if I could say I don't feel at all beaten up on by my friend, Mr. Markey, who I go back with a full 27 years. And I also remember the discussions concerning the Pole Attachment Act back in 1978, when poll attachments were and still remain essential.

Mr. MARKEY. I think Mr. Sachs wrote the language to be honest with you.

Mr. SACHS. As a staff for this committee, in fact. But fast forward to the present, and we visited a few months back and Congressman Markey told me that he felt he had started to mellow over time. And I do note that. I mean this is a very, you know, pleasant repartee.

Mr. ENGEL. Let me just say, Mr. Sachs, you are the only one in this room that thinks that Congressman Markey has mellowed.

Mr. SACHS. He thought he had mellowed as well. But we really are—our industry had experience from 1992 through 1996 and then for 3 more years because deregulation of our core video service didn't take place until April 1999. And we saw the impact of regulation on this business. Capital spending, at that time period, averaged $3 to $4 billion a year for the entire industry. It wasn't until the 1996 Telecommunications Act and the prospect of deregulation 3 years later, with respect to our video services, that we were able to raise capital, and investors were willing to take the risk on this business. So—and since 1996, that capital investment has averaged more than $10 billion a year. The contrast is stark. So given our own experience with very invasive regulation for that period of time, we came away from that experience chastened and also with the recognition that we don't want to come before Congress or the FCC as an industry and seek to tie up other industries in this sort of regulation. We would rather compete on every street and for every household's business.

Mr. ENGEL. Thank you. Thank you, Mr. Chairman.

Mr. UPTON. Well, we appreciate everybody's testimony this afternoon. And we look forward to hearing from some of you in September, when we hope that this, at least part of this, issue is over and done with. And I know, Dr. Pepper, if you take that back to the Chairman, it would be most appreciated.

We will consider this hearing for today adjourned.

[Whereupon, at 5:43 p.m., the subcommittee was adjourned.]

[Additional material submitted for the record follows:]

PREPARED STATEMENT OF THE NATIONAL LEAGUE OF CITIES, UNITED STATES CONFERENCE OF MAYORS, NATIONAL ASSOCIATION OF COUNTIES, NATIONAL ASSOCIATION OF TELECOMMUNICATIONS OFFICERS AND ADVISORS AND TELECOMMUNITY

I. INTRODUCTION

This testimony is submitted on behalf of the National League of Cities ("NLC"), the U.S. Conference of Mayors ("USCM"), the National Association of Counties ("NACO"), the National Association of Telecommunications Officers and Advisors ("NATOA") and TeleCommUnity (collectively referred to as "Local Government."). The National League of Cities, United States Conference of Mayors and National Association of Counties collectively represent the interests of almost every local government in the United States. NATOA's members include telecommunications and cable officers who are on the front lines of communications policy development in hundreds of local governments. TeleCommUnity is an alliance of individual local governments and their associations, which seeks to refocus attention in Washington on the principles of federalism and comity for local governments' interests in telecommunications.

II. LOCAL GOVERNMENT'S UNIQUE PERSPECTIVE

The Subcommittee at its hearing on July 21st chose to limit the regulatory witnesses from whom it heard to federal and state broadband regulators. Local government offers this testimony to clarify for the Subcommittee the numerous roles local government plays in broadband services such as:

- Enforcers on behalf of citizens of customer service and privacy requirements relating to the provision of services over the cable system,
- Regulators and administrators of cable systems and services,
- Extensive users of telecommunications resources,
- Developers and promoters of broadband applications,
- Economic development agencies in promoting deployment of broadband facilities,
- Trustees, owners, and managers of valuable public property, and

• Mediators among competing uses of the public rights of way

As confirmed by all at the hearing, cable modem services are the most universally available broadband service to residential consumers. Local cable franchising requirements and enforcement played a large role in the wide availability of cable modem service as this testimony will clarify.

Local government also files this testimony to document that it has unique experiences, wisdom and perspective that must be heard in this debate if the policies which the Congress creates for broadband services are to benefit consumers, not merely focus on the treatment of broadband service.

Finally, the Subcommittee would be well served to be informed of some of the other challenges local governments face as we seek to protect consumers in their dealings with cable operators in their roles as cable providers.

A. How Local Government differs from FCC and state PUCs.

The role of local governments is far more complex than that of the Federal Communications Commission and state public service commissions who have traditionally been pure regulators. Local governments have a significant proprietary interest in the property used by communications systems to deliver service to end-users. It is well known that wireline systems use and depend upon public rights-of-way to provide service.[1] But local governments also own and maintain streetlights, traffic signals, water towers, poles, conduits and other structures that are used by both wireline and wireless providers to reach their customers.[2]

In addition, perhaps more than any other level of government, local governments are actively engaged in promoting economic development. Local governments have attempted to promote economic development by encouraging competition in communications markets. Communities have, for example, built "conduit freeways" in conjunction with public works projects in order to make it easier for competitors to enter the market, developed local networks in conjunction with private industry to promote facilities-based competition, and devised public rights-of-way policies that protect vital infrastructure, while making it easier for companies to enter the market.[3]

Economic development is not just about placing hardware in the ground, however. Consumers will not take advantage of broadband unless broadband offers beneficial, real world applications.[4] Local governments are developing and promoting applications that take advantage of the promise of broadband through a variety of initiatives, including distance learning initiatives, and initiatives designed to make broadband universally available.

Because local governments are so diverse, and because they work so closely with the public, local governments—assuming they have adequate resources—offer the best hope for development of robust e-government applications. To paraphrase the Communications Act, the goal at the local level is to "make available, so far as possible, to all the people" in the community "without discrimination on the basis of race, color, religion, national origin, or sex," rapid, efficient, advanced communications systems *and* to encourage the use of these systems. See 47 U.S.C. § 151.

Local governments thus act as trustees/owners/managers of valuable public property, mediators among competing uses of the public rights-of-way, economic development agencies in promoting deployment of broadband facilities, users of extensive

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[1] See *Turner Broadcasting System, Inc. v. FCC,* 512 U.S. 622, 627-28 (1994) ("Cable systems, by contrast, rely upon a physical, point-to-point connection between a transmission facility and the television sets of individual subscribers. Cable systems make this connection much like telephone companies, using cable or optical fibers strung aboveground or buried in ducts to reach the homes or businesses of subscribers. The construction of this physical infrastructure entails the use of public rights-of-way and easements and often results in the disruption of traffic on streets and other public property. As a result, the cable medium may depend for its very existence upon express permission from local governing authorities. *See generally Community Communications Co. v. City of Boulder,* 660 F.2d 1370, 1377-78 (10th Cir. 1981).")

[2] In Coral Springs, Florida, for example, the City established a procedure for leasing municipal property for use by wireless providers for placement of antennas. The City owned several structures that made it easier for service providers to reach cars passing by the City on the interstate. Coral Springs, Fla., Land Development Code, Ch. 25, art. XIV, § 2501012.

[3] *See* National Research Council, *Broadband Bringing Home the Bits,* National Academy Press (2002), at 206.

[4] *Little Demand For Paid Consumer Online Services, Reports Jupiter Media Metrix,* PR Newswire, May 22, 2002 ("Jupiter's latest research indicates that there is no obvious killer-app online service that consumers would pay for," said David Card, Jupiter Research vice president and senior analyst."); *BUSH ADMINISTRATION FOCUSES ON INCREASING DEMAND FOR BROADBAND,* Communications Daily, March 6, 2002 ("Many consumers don't yet see the value of broadband,"...in Atlanta, price point of zero still wasn't sufficient motivation for half of consumers."); *Broadband waits for 'killer app', analysts say: Average consumers see no reason to move to high-speed,"* Dallas Morning News, Sept. 18, 2001.

communications resources, and developers and promoters of broadband applications and protectors of consumer services and privacy. This is not to say the regulatory role of local government is unimportant or insignificant: local governments have had traditional responsibilities for protecting consumers and promoting competition dating back to the beginning of the Republic. *Charles River Bridge* at 547. The point is that any Congressional discussion of broadband services can not simply be about regulation. Congressional oversight of the FCC treatment of cable modem services and other broadband service providers vitally affects local governments in all of their roles.

B. Local Franchising Benefits Cable Operators and Protects Local Communities and Subscribers.

Local governments[5] grant cable franchises as a means of:

- Promoting deployment and competition;
- Protecting the public rights-of-way and the vital facilities located therein;
- Promoting localism and viewpoint diversity in video programming and ensuring that the future cable-related needs of the community will be met; and
- Protecting subscriber privacy rights, enforcing consumer protection statutes, and ensuring compliance with customer service standards.

Through the franchising process, cable operators have obtained the special privilege to semi-permanently use and occupy the public rights-of-way with over one million miles of cable plant as a means to annually deliver almost $50 billion worth of cable and other services to almost 69 million subscribers. In return, cable operators agree to comply with local government right-of-way regulations, construction standards, and customer service regulations; to provide rental compensation, both monetary and in-kind services and facilities; and agree to provide access channels and support for local public, educational and governmental ("PEG") programming, as well as municipal institutional network facilities and support services.

While cable operators built their broadband systems based on cash flow from all subscribers, absent a the ability of local government to enforce its universal service or availability requirements, cable operators will be free to cherry pick to whom they will offer broadband services.

C. Local Franchising Promotes Broadband Competition and Deployment.

Local governments grant incumbent cable operators and competitive broadband providers non-exclusive franchises to use public property to provide cable service and non-cable services.[6] Build-out schedules, system upgrade requirements, and anti-redlining provisions have long been among the core franchise conditions negotiated by local governments.[7]

A local government cable franchise regime—*i.e.,* operators and local governments negotiate franchise requirements, operators pay five percent franchise fees and provide PEG channel capacity and support, local governments enforce customer service standards and regulate rates—has been in place for more than seventeen years and it has been a highly successful industry model. For example, as of June 2002:

- Cable plant reaches 97% of all households.[8]
- 80% of all cable plant has been rebuilt since 1996 to be capable of providing digital services.[9]
- There are approximately 16 million cable modem lines deployed,[10] reaching 50 million homes, and serving between 6.9 and 7.4 million subscribers. (It should be noted that the FCC required cable receive a jump start on this number. Under the "social contracts" the FCC required of Time Warner systems to deploy modems to all schools.)

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[5] In a small number of states, franchising is performed by a state agency.

[6] Grants of exclusive franchises, rare in any case, were prohibited by the 1992 Cable Act. 47 U.S.C. § 541(a)(1). New entrants and incumbent cable operators are using new and upgraded systems to offer bundled combinations of video programming, Internet access, and telephone service to increase per subscriber revenues.

[7] *See also* 47 U.S.C. § 541(a)(3); 47 U.S.C. § 541(a)(4)(A).

[8] *In re Annual Assessment of the Status of Competition in the Market For the Delivery of Video Programming,* MB Docket No. 02-145, Ninth Annual Report, 17 FCC Rcd 26,901, Table 1 (2002)("*Ninth Annual Report*") http://gullfoss2.fcc.gov/prod/ecfs/retrieve.cgi?native_or_pdf=pdf&id_document=6513404824

[9] *Ninth Annual Report* at ¶33.

[10] FCC Wireline Competition Bureau Industry Analysis and Technology Division, *High Speed Services for Internet Access: Status as of June 30, 2002* at Tables 1, 2 ("June 2002 High Speed Report"), available at http://www.fcc.gov/wcb/stats.html (9.2 million high-speed [200 kbps in one direction] and 6.8 million advanced service [200 kbps in both directions] lines).

In contrast, as of June 2002, ADSL[11] and other forms of broadband which have not generally been subject to local franchise fees, franchise build-out and anti-redlining requirements have deployed only 6.3 million high-speed and advanced service lines to residential and small businesses, and serve between 3 and 3.3 million residential subscribers.[12]

D. Local Franchising and Regulation Protects All Right-of-Way Users.

Cable operators are not the only users of the public rights-of-way. The public rights-of-way also contain millions of miles of telecommunications fiber, copper telephone wiring, electrical lines, and millions more miles of gas, water and sewer pipes and mains. Automobiles and mass transit, as well as pedestrians and bicyclists, rely on use of the public rights-of-way as well, often necessitating installation and maintenance of thousands of traffic control signals, cameras, and even speed detectors. All told, the combined value of the public rights-of-way owned (or held-in-trust for public use) by local governments is over $7.1 trillion.[13] And in most cases, it falls to local governments to exercise both proprietary and police powers to coordinate and manage these diverse and competing uses, protect all users from damages by other users, and to prevent waste or premature exhaustion of this valuable public asset.

E. Local Franchising Promotes Local Programming, Viewpoint Diversity, and the Community's Cable-Related Needs and Interests.

Local governments negotiate with cable operators to obtain channel capacity on cable systems for the purpose of presenting primarily local, public, educational, and government access programming. Cable is the primary means of communicating with over 76% of all television households[14] and access channels are the primary means of ensuring that programming content is not exclusively controlled by the owners of these powerful communications systems. Access channels are used by a wide range of community groups to carry local community programming, educational K-12 programming, distance learning courses for students of all ages, federal and local government programming, and emergency information alerts.[15] (Many Members of the House of Representative are familiar with PEG channels as they use these channels to communicate with constitutes while back in the district or from Washington.). Local governments have also used the franchising process to bring Internet access to schools and to create municipal institutional networks ("I-Nets") to support e-government initiatives. These institutional networks provide vital redundant telecommunications infrastructure. For example, some of the New York City communications infrastructure was destroyed in the September 11, 2001 World Trade Center attack, but the New York I-Net system rerouted signals as it was designed to do, and provided vital communications links during the emergency crisis period.

F. Local Governments Enforce Customer Service Standards and Privacy Protections.

Local governments have broad authority under federal and state law to protect subscriber privacy and to enforce customer service standards against cable operators.[16] Local governments use this authority to ensure that subscribers receive what they paid for at the level and quality of service advertised; as incentive to persuade cable operators to resolve service and billing complaints in a timely manner; and to make certain that subscriber privacy is protected to the fullest extent permitted

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[11] Asymmetrical Digital Subscriber Line service is faster in one direction, usually subscriber downloading, and is primary used to serve residential areas. Symmetrical DSL provides equal speeds in both directions is typically deployed to serve large businesses.

[12] *June 2002 High Speed Report* at Tables 3 and 4.

[13] TeleCommUnity, "Valuation of the Public Right-of-Way Asset," March 2002, available at http://www.telecommunityalliance.org/images/valuation2002.doc.

[14] *Ninth Annual Report* at App. B, Table B-1. This table has been attached as an Appendix to this testimony.

[15] "Public, Educational and Governmental (PEG) access television channels on cable television systems serve a wide range of community groups including: the Lions, Kiwanis and Rotary Clubs, the League of Women Voters, NAACP, AARP, the Urban League, public schools, local Chambers of Commerce, religious institutions, colleges and universities, community theaters, labor unions, veterans groups, second language communities, the disabled, politicians, and political organizations. Additionally, PEG channels carry programming from NASA, the US Department of Education, the Organization of American States, Members of Congress, the National Guard, the US Army, the US Air Force, the Federal Emergency Management Administration (FEMA), the US Department of Housing and Urban Development (HUD), and various arts organizations such as Annenberg/CPB and Classic Arts Showcase." Alliance for Community Media, "About Community Media," available at http://www.alliancecm.org/.

[16] 47 U.S.C. § 551, 552.

under law.[17] The need to protect subscriber privacy becomes even more important as more broadband services are offered over cable systems.[18]

• **Cable Modem.** Congress empowered local governments to enforce "customer service requirements of the *cable operator*," not merely requirements related to "cable service."[19] Thus, regardless of whether cable modem service is classified as a cable, information or telecommunications service, local governments have authority to continue to require cable operators to comply with local customer service standards and consumer and privacy protections, regardless of the type of service offered.

CONGRESS SHOULD RESPECT LOCAL GOVERNMENTS' AUTHORITY TO COLLECT COMPENSATION FROM ANY RIGHT-OF-WAY OCCUPANTS.

A. The Fact That A Service Is A Broadband /Information Service Does Not Affect Local Authority To Manage Public Rights-of-Way or To Require Franchises.

There are enormous public policy and constitutional issues that would be raised if the Cable or Telecommunications Act were read to preempt local authority to charge fees for use and occupancy of the public rights-of-way just because a service provider offered a broadband or information service.

Supreme Court precedent makes it clear that the Cable Act must be read to permit localities to charge fees unless there is *no possible* reading of the statute under which such charges could be permitted. Thus, for example, *Gregory v. Ashcroft,* 501 U.S. 452, 464 (1991), held that intrusions on traditional state authority will only be given effect when a statute's language makes the Court "absolutely certain that Congress intended" such a result. The rule, described by Professors William Eskridge and Philip Frickey as "superstrong,"[20] "increases Congress's political accountability by forcing it to state explicitly a decision to erode state authority and reduce the benefits of federalism—such as "decentralized government that [is] more sensitive to the diverse needs of a heterogeneous society [and that] increases opportunity for citizen involvement in democratic processes' that accrue to the polity."[21] Particularly given the impact on basic infrastructure and on the public of the upgrades associated with providing cable modem service it is fair to expect that had Congress meant to intrude so extraordinarily into state sovereignty it would have done so directly—and taken the responsibility for the results.[22] It did not do so, and therefore the Constitution requires that the Act be construed to preserve local authority to charge a fee for use and occupancy of the public rights-of-way to provide information services if at all possible:

> Where an administrative interpretation of a statute invokes the outer limits of Congress' power, we expect a clear indication that Congress intended that result. *See Edward J. DeBartolo Corp. v. Florida Gulf Coast Bldg & Constr. Trades Council,* 485 U.S. 568, 575 (1988). This requirement stems from our prudential desire not to needlessly reach constitutional issues and our assumption that Congress does not casually authorize administrative agencies to interpret a statute to push the limit of congressional authority. *See ibid.* Thus, "where an otherwise acceptable construction of a statute would raise serious constitutional problems, the Court will construe the statute to avoid such problems unless such construction is plainly contrary to the intent of Congress." DeBartolo at 575.

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[17] *See e.g.,* Seattle, WA Ordinance No. 12775, available at http://www.cityofseattle.net/cable/customer_service.htm (customer service standards, customer credits and privacy policy).

[18] *See e.g.,* Christopher Stern, "Comcast Halts Tracking of Its Subscribers; Privacy Activists Had Criticized Practice of Collecting Data on Visits to Web Sites," *Washington Post,* Feb. 14, 2002, at E4; Brigitte Greenberg, "Privacy Complaints Prompt Change in Comcast Web Policy", *Communications Daily,* Feb. 14, 2002.

[19] 47 U.S.C. § 552(a). See Comments of Alliance of Local Organizations Against Preemption at 67-68, *In re Appropriate Regulatory Treatment for Broadband Access to the Internet Over Cable Facilities,* Notice of Proposed Rulemaking, CS Docket No. 02-52, 17 FCC Rcd 4798 (2002), available at http://gullfoss2.fcc.gov/prod/ecfs/retrieve.cgi?native_or_pdf=pdf&id_document=6513198533

[20] William N. Eskridge, Jr. & Philip P. Frickey, *QuasiConstitutional Law: Clear Statement Rules as Constitutional Lawmaking,* 45 Vand. L. Rev. 593, 623(1992)

[21] Jack W. Campbell, *Regulatory Preemption in the Garcia/Chevron Era,* 59 U. Pitt. L. Rev. 805, 816 (1998).

[22] The Commission's decision to announce that cable operators need not pay fees, at the same time that it tells consumers to look to local governments for protection against cable modem abuses, is an unfortunate example of a federal agency passing the buck in two senses—telling consumers to look to local governments for protection, while taking the bucks from local government required to provide that protection.

Solid Waste Agency of Northern Cook County v. U.S. Army Corps of Engineers, 531 U.S. 159, 173 (2001). *See also, I.N.S. v. St. Cyr,* 533 U.S. 289, 299-300 (2001) ("[I]f an otherwise acceptable construction of a statute would raise serious constitutional problems, and where an alternative interpretation of the statute is 'fairly possible,' *see Crowell v. Benson,* 285 U.S. 22, 62 (1932), we are obligated to construe the statute to avoid such problems. *See Ashwander v. TVA,* 297 U.S. 288, 341, 345-48 (1936) (Brandeis, J., concurring); *United States ex rel. Attorney General v. Delaware & Hudson Co.,* 213 U.S. 366, 408 (1909).")

B. Collecting Payment for Use of Public Property by Commercial Enterprises is Sound Public Policy Encouraged by the Congress.

In addition to the arguments that the Congress cannot prohibit localities from charging fees for the use and occupancy of public rights-of-way to provide broadband services, it is good public policy to charge private companies fair value for property used.

Congress has long recognized that requiring communications companies to pay fair market value for the inputs used in their business encourages competition and economic deployment of resources. Spectrum auction, for example, generated huge revenues for the Treasury, but the effect was to encourage competition and deployment, rather than discourage it. In its report to the Congress on these auctions the FCC concluded:

> "the competitive bidding process provides incentives for licensees of spectrum to compete vigorously with existing services, develop innovative technologies, and provide improved products to realize expected earnings. In this way, awarding spectrum using competitive bidding aligns the licensees" interests with the public interest in efficient utilization of the spectrum. As one commenter observes, "[s]uccessful bidders are those that not only place a high value on the property relative to other auction participants, but also have the financial capability to support their bids."[23]

The same is true with respect to charging for use of public rights-of-way: allowing localities to charge fair value will not discourage use of the public rights-of-way if an enterprise is sound; but it will discourage uneconomic uses.

Indeed, the recent problems in the broadband industry generally have been exacerbated by over-investment. The last thing the industry needs is an incentive to misallocate resources.[24] Charging fair market value for the use of rights-of-way will help companies make more rational investment decisions. As the Third Report notes at ¶ 62:

> "there has been a recent slowdown in investment caused by the economic downturn generally, and more particularly, over-building by carriers, over-manufacturing by vendors, over-capitalization by financial markets, coupled with unrealistic market expectations by investors. [Analysts] conclude that, although it will take some time for the industry to absorb excess bandwidth capacity and increase utilization of existing assets, the recent slowdown in investment has not been caused by a slowdown in consumer demand."

Charging fees for use of the public rights-of-way prevents what would otherwise be substantial subsidies running from the public to broadband operators. The industry consistently underestimates costs associated with use of the public rights-of-way. The costs involve far more than the direct costs of overseeing public right-of-way construction (costs associated with permitting and inspecting, for example), coordinating public right-of-way construction (police supervision and traffic control) and responding to construction-related complaints. Construction reduces the life of the roadway,[25] reduces the space available in the roadway to others, makes coordination of public projects more difficult (and expensive) and often damages vital utility infrastructure in ways that may not be detected until much later. As importantly,

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[23] *FCC Report to Congress on Spectrum Auctions,* WT Docket No. 97-150, Report, FCC 97-353, at § IV(B)(1997).

[24] *See* Brian Leaf, *Battling Waves of Woe: Once high-flying industry getting swamped,"* Crain's Chicago Business, Feb. 25, 2002 ("As companies rushed to install fiber optic cables—the autobahn of the new economy—they went overboard. Now, the capacity glut has cost telecom companies billions of dollars, with no foreseeable return on their investment."); Jeff Smith, *Fiber-Optic Fallout; Billions Were Wasted in Frenzy to Build Networks, 90% of which lie Dormant,* Rocky Mountain News, May 6, 2002, at 1B; Jon Healey, *Telecom's Fiber Pipe Dream,* Los Angeles Times, April 1, 2002, at A1 ("The problem was that too many companies had the same dream, and they built too many digital toll roads to the same destination.")

[25] Ghassan Tarakji, San Francisco State University, The Effect of Utility Cuts on the Service Life of Pavements in San Francisco: Study Procedure and Findings (1995); IMS, Infrastructure Management Services, Inc., Estimated Pavement Cut Surcharge Fees for the City of Anaheim, California Arterial Highway and Local Streets (1994).

construction imposes significant, uncompensated costs on the public. In some cases, those costs are as simple (and as significant) as delays in traffic and damage to vehicles,[26] but in other cases, critical access routes to local businesses are cut off.[27] In some cases, the impact can be fairly described as disastrous.[28] The University of Minnesota has concluded that installation of utility infrastructure imposes substantial costs on the public.[29]

IV. NON BROADBAND CHALLENGES FACING LOCAL GOVERNMENT IN OVERSIGHT OF CABLE OPERATIONS

A. Local Government Rate Regulation Authority Is Limited.

Real competition creates downward pressure on rates.[30] Local rate regulation has been used as a substitute rate restraint where there is no real competition to protect consumers from unreasonable rates. Unfortunately, as explained below, local government actions to ensure reasonable rates for subscribers have been stymied by illogical FCC rules, interpretations, and unreasonable rate-setting formulas.[31]

In addition, the effectiveness of basic rate regulation is hampered by the lack of regulation of other service tiers. For example, if a local government determines that an operator's basic rate is more than what would be charged if a competitive market existed, the operator can simply charge more for the unregulated tiers, thereby ensuring that subscribers will continue to pay the unreasonable rate selected by the operator. As one operator bluntly stated:

> If, during the appeal process and prior to a final decision by the FCC, Time Warner Cable is required to implement the Rate Order, it is our intention to provide the ordered customer refund during 1 billing period. It is also our intention to adjust our CPST Service tier price by a like amount during that 1 billing period . . . If the Rate Order is implemented, the only customers who will realize a net refund and/or reduction in total service price are those 2,930 customers subscribing only to basic service.[32]

B. Cable Industry Deregulation has led to Less competition, not Lower Rates.

Cable rates continue to rise unreasonably because cable incumbents lack viable wireline competitors, not, contrary to the claims of the cable industry, because programming costs continue to rise. In the past, cable operators used their control over a la carte tier pricing as a means to charge more, not less, per channel. Today, consolidated cable behemoths are using ownership control of sports and news programming, predatory pricing tactics, and geographic rate discrimination as means to drive out wireline competition. Cable operators should be held accountable for their attempts to evade current rate regulations, not rewarded with further deregulation.

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[26] Lyndsey Lawton, *Hidden Cost of Road Tear-ups: D.C. Taxpayers Struck With Bill for Trench-Weakened Streets,* The Washington Post, March 15, 2000, at A1.

[27] Lyndsey Lawton, *Despite Promises, Road Work Still Chaotic, Only 1 Cut Coordinated Out of 507 Permitted,* The Washington Post, August 13, 2000, at C1; Lyndsey Lawton, *Mayor Vows to Bring Order to Street Work; Longer Moratorium on Trenches Is Possible,* The Washington Post, March 28, 2000, at B1.

[28] Joanna Glasner, *High Bandwidth Bureaucracy,* Wired News, March 25, 1999; Rachel Horton, *City Urges Conservation After Water Line Slashed,* Irving News, July 11-14, 1999, at 1A.; Rani Cher Monson and Melissa Borden, *3,600 Lose Emergency Phone Service,* Arlington Morning News, July 16, 1999, at 1A; Stephen C. Fehr, *Road Kill on the Information Highway,* The Washington Post, March 21, 1999, at A1; Jim Hannah and Cindy Schroeder, *Fiber-optic cut disrupts business computers snarled in Kenton Co.,* The Cincinnati Enquirer, February 28, 2001; Blake Morrison and Amy Mayron, *Buried Stone May Have Caused Break Submerged Block Diverted Auger to the Side, Piercing Gas Line,* St. Paul Pioneer Press, December 13, 1998, at 1A.

[29] Raymond L. Sterling, University of Minnesota, Indirect Costs of Utility Placement and Repair Beneath Streets (1994).

[30] Brigitte Greenberg, "Cable Prices Rise More Than Other Goods and Services," *Communications Daily,* Jan. 15, 2002, at 6.

[31] For a fuller discussion of local government recommendations for rate regulation reform, see Comments and Reply Comments of National Association of Telecommunications Officers and Advisors, National League of Cities, Miami Valley Cable Council, Montgomery County, Maryland, and City of St. Louis Missouri, *In re Revisions to Cable Television Rate Regulations,* Notice of Proposed Rulemaking and Order, MB Docket No. 02-144, 17 FCC Rcd 16,803 (2002), *available at* www.fcc.gov/searchtools.html, "Search For Filed Comments—ECFS," Proceeding "02-144," Filed on Behalf of "NATOA" and "National Association of Telecommunications Officers and Advisors."

[32] "Time Warner Settlement Letter," Letter from Gerald DeGrazia, Time Warner Cable, to Kent Bristol, Executive Director, Miami Valley Cable Council (Nov. 5, 2002), attached as Exhibit B, Attachment 14 to *Errata to Opposition to Appeal of Local Rate Order, Time Warner v. Miami Valley Cable Council,* (filed Dec. 6, 2002), available upon request.

C. Expanding Cable Operator Control of Programming Is Unlikely to Reduce Cable Rates.

1. Cable Operators Historically Used À La Carte Pricing to Evade Rate Regulation.

In 1994, the initial cable rate regulation rules exempted single-channel "à la carte" offerings. Operators began offering à la carte channels on a single and à la carte tier package basis. The single channel price, however, was so high that it only made sense to purchase à la carte channels as a tier package. However, because each channel in the à la carte tier was technically available as a single à la carte channel, cable operators claimed that the à la carte tier package was not subject to rate regulation (as other programming tiers were). On an ad hoc basis, the FCC permitted this à la carte tier arrangement so long as six or fewer channels were packaged together.[33] Ultimately, the FCC found no sufficient justification for the tier restructuring "other than to avoid rate regulation."[34] Despite this finding, however, the FCC neither prohibited this evasion, nor sanctioned the operators for trying to avoid compliance with rate regulation rules.

The unfortunate consequence of the FCC response is that it creates an implicit incentive for cable operators to aggressively interpret the rate rules to their benefit. For example, an operator with 10 million subscribers manipulates a rule interpretation to add an additional ten cents per month to every subscriber bill. In one year, the rate manipulation has generated $12 million. Even if the ten-cent addition is denied by a local government in a large jurisdiction with 200,000 subscribers, and the FCC rules on appeal that the ten-cent charge was unlawful, at worst, the operator would have to refund $240,000 to the 200,000 subscribers. But it will likely keep the other $11 million it unlawfully collected from other subscribers because the FCC is not going to assess a separate fine or make the FCC Order apply beyond the jurisdiction that issued the challenged Rate Order.

2. À La Carte Pricing Could Result in Channel Substitution, Not Lower Rates.

Cable operators cannot offer every channel on an à la carte basis. Operator-owned programming interests may affect decisions as to which channels will be offered as part of a package or as an à la carte channel. Congress should be concerned about channel substitution. For example, assume in New York City that Cablevision agrees to carry YES Network, drop ESPN from its expanded-tier programming, and make ESPN available as a separate à la carte channel. If there are no substantial savings in programming costs between YES and ESPN, or if programming cost savings are not passed onto subscribers, then the subscriber who did not want sports programming would see no price reduction, and the subscriber who wanted ESPN will have to pay the same price to receive ESPN-less programming or a larger price to receive the same programming with ESPN.

D. Cable Operators Have Not Presented Verifiable Programming Cost Data.

Verifiable programming cost and revenue data is needed to evaluate the impact of programming costs on cable rates. Notwithstanding the fact that a Justice Department investigation and an informal SEC inquiry related to the accuracy of operator-reported data are currently pending,[35] Congress should require the cable industry to provide specific information about all channel programming costs, programming launch fee revenue, and corporate allocation of volume discounts.

• **Actual Programming Costs.** Cable operators submit only their basic tier channel programming costs to local governments as part of the rate regulation process and do not routinely submit any programming costs to the FCC. Thus, cable operators do not disclose to any regulatory body what they are paying for most of their programming.

• **Accounting Treatment of Launch Fee Revenue.** Cable operators receive substantial "launch fees" from programmers—*i.e.,* fees for adding new channels to cable systems, for advertising new channels on existing channels, in program guides, on or with subscriber bills, and for other channel launch-related services—

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[33] *See, e.g., In the Matter of: Adelphia Cable Partners, L.P., South Dade County, Florida, Letter of Inquiry,* Memorandum Opinion and Order, 9 FCC Rcd. 7781 (1994) (rejected justification where 32 channels were placed on an "à la carte" tier, although operator was not sanctioned for the attempted evasion).

[34] *In re Comcast Cablevision of Tallahassee, Florida, Letter of Inquiry,* Memorandum Opinion and Order, 9 FCC Rcd 7773, ¶15 (1994); *aff'd* by full Commission, *In re Comcast Cablevision of Tallahassee, Florida, Application for Review,* Memorandum Opinion and Order, 11 FCC Rcd 1246 (1995).

[35] Riva D. Atlas and Geraldine Fabrikant, "Large Cable Operator to Restate its Results for 2000 and 2001", *New York Times,* Nov. 20, 2002, at C1.

but do not uniformly treat them as programming revenues which offset total programming costs.

• **Allocation of Volume Discounts.** Cable operators often delay or refuse to comply with local government requests to disclose terms of their programming contracts, thus making it difficult to determine how volume discounts are allocated. In at least one instance, franchise-level *reported programming costs were greater than the operator's actual costs* because the operator negotiated volume discounts for programming, but charged its local franchises as if no discount had been obtained, booking the difference as profit for the corporate parent. According to the 2001 Annual Report Comcast filed with the SEC:

> "[O]n behalf of the company, Comcast secured long-term programming contracts . . . Comcast charged each of the Company's subsidiaries for programming on a basis which generally approximated the amount each subsidiary would be charged if it purchased such programming from the supplier . . . and did not benefit from the purchasing power of Comcast's consolidated operations." [36]

E. The Effect of Programming Cross-Ownership Remains Unknown.

Without actual programming cost data, it is also difficult to evaluate what effect cable operator cross-ownership of programming networks has had on increases in programming costs and cable rates. Cable operators could be recovering programming fees from subscribers, while also benefiting from fee increases through their programming network ownership agreements. The FCC reported: [37]

- Combined, four of the top six cable operators hold ownership interests in 72 of 92 satellite-delivered programming networks.
- AOL Time Warner has an ownership interest in 39 networks, i.e., 13% of all national programming networks.
- Cox has an ownership interest in 25 networks, i.e., 8% of all national programming networks.
- Comcast has an ownership interest in 9 networks, i.e., 3% of all national programming networks.
- Cablevision has an ownership interest in 5 networks, i.e., 2% of all national programming networks.
- Liberty Media has an ownership interest in 41 networks, or 13% of all national programming networks.
- Comcast has an ownership interest in several regional sports programming channels, and sports programming has been cited as major source of programming fee increases.

Local governments urge the Subcommittee to take steps to protect subscribers from potential abuses of à la carte pricing, to ensure transparent and equitable accounting treatment of programming costs and revenues, and to investigate how cable operator cross-ownership of programming affects subscriber rates.

F. Without Wireline Competition, Cable Rates Will Continue to Rise.

At the July 21st hearing, there was reference made to competition for cable. In response to a question from Chairman Tauzin, Mr. Sachs indicated that less than five percent of cable operators face head-to-head competition with wireline competitors.

In separate studies, both the GAO and the FCC found that cable rates are lower in areas where competing cable service is available from a second wireline provider than in areas where there is no wireline competition. The GAO study found cable rates to be 17% lower, and the FCC found rates were 8% lower, where a second wireline competitor exists.[38] However, according to the FCC, only 2% of the 33,246 cable community units have competition from more than one wireline provider.[39] The seven largest cable operators, which account for 83.8% of all cable sub-

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[36] *See* Comcast Cable Communications, Inc., *Form 10-K Annual Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 For the Fiscal Year Ended December 31, 2001,* at 42 (filed March 29, 2002) *available at* http://www.sec.gov/Achives/edgar/data/1040573/000095015902000190/cable10k.txt.

[37] *Ninth Annual Report* at ¶135.

[38] United States General Accounting Office, *Telecommunications Issues in Providing Cable and Satellite Television Service,* Report to the Subcommittee on Antitrust, Competition, and Business and Consumer Rights, Committee on the Judiciary, U.S. Senate, at 9, GAO-03-130 (2002)("*GAO 2002 Study*"), *available at* http://www.gao.gov/cgi-bin/getrpt?GAO-03-130; *In re Statistical Report on Average Rates for Basic Service, Cable Programming Service, and Equipment,* Report On Cable Industry Prices, MM Docket No. 92-266, 17 FCC Rcd 6301, Table 6 (2002) ("*2002 Cost Report*"). This table has been attached as an Appendix to this testimony.

[39] *Ninth Annual Report* at ¶115.

scribers,[40] are incumbents that do not compete against each other. The largest of these is Comcast with over 21 million subscribers, and the seventh largest is Mediacom with 1.5 million subscribers.[41] In contrast, the three largest competitive cable providers,[42] which compete in the same markets against the largest cable operators, are RCN with 426,700 subscribers, WideOpenWest with 310,000, and Knology with 124,700.[43]

1. DBS Service Does Not Constrain Cable Rates.

Both the GAO and FCC have determined that the provision of DBS service does not have any effect on cable rates.[44] The National Cable Television Association ("NCTA") submitted statements to the FCC stating that market power is restrained to the extent that there are competitive alternatives available to which customers could turn if a cable operator attempted to raise its prices.[45] Local governments offer the following factors as possible explanations as to why DBS does not present a true "competitive alternative" for the customer and thus does not restrain cable prices:

- **Non-Interchangeable Equipment.** Wireline competition may be more price competitive than DBS against incumbent cable service because it is easier for customers to switch between wireline competitors using cable modem and set-top boxes than it is for customers to switch between dish systems and cable boxes.
- **Provision of local channels.** In the GAO study, 47% of respondents cited the ability to receive local broadcast and cable channels from the same provider as a major reason for selecting cable, and DBS providers confirm that provision of local broadcast channels increases subscription rates.[46] Yet local broadcast channels are offered by DirecTV or Echostar in only 62 of 210 television markets and local channels are offered by both providers in only 41 markets. In addition, DBS does not carry local PEG programming.

G. Consolidated Cable Incumbents Are Using Aggressive Marketing to Eliminate Wireline Competitors.

Competitive broadband providers, including nascent cable system overbuilders, have complained of incumbent cable operators using aggressive marketing tactics—including deeply discounted introductory rates, *e.g.*, $24.95 per month for 200 channels compared to $77.90 per month in the neighboring community without wireline competition; cash bonuses, e.g., $200 to switch to the incumbent's cable service and another $200 to switch to the incumbent's Internet service; and forgiveness of old debt owed by subscribers to the incumbent—to drive these small competitors out of the market entirely.[47] It is also unclear whether the neighboring community's rates

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[40] *Ninth Annual Report* at App. B, Tables B-1, B-3. Comcast and AT&T are counted as single operator. The combined percentage of AT&T, Time Warner, Comcast, Charter, Cox, Adelphia, Cablevision, and Mediacom's share (64.16%) of all MVPD subscribers (89,890,641) equals 57,673,835, which is 83.8% of 68.8 million cable subscribers.

[41] *Ninth Annual Report* at App. B, Table B-3. Comcast's share of 89,890,641 MVPD subscribers is the sum of AT&T's 14.75% plus Comcast's 9.46% as reported in June 2002. Mediacom reported 1.76%.

[42] These cable providers or overbuilders prefer to be called "broadband providers" as they provide competitive video programming, Internet access, data and telephone services.

[43] *Ninth Annual Report* at ¶ 117 and n.354. RCN reported 506,700 basic subscribers as of June 2002, but the FCC noted the current number of subscribers is 80,000 less due to a sale for cash in August 2002 of certain RCN systems in New Jersey. RCN Corp., "RCN to Receive $245 Million for Non-Strategic New Jersey Cable Systems" (press release), Aug. 27, 2002.

[44] *GAO 2002 Study* at 9; *2002 Cost Report* at Table 6. GAO found that cable operators respond to DBS competition by adding more channels. *GAO 2002 Study* at 10.

[45] *Ninth Annual Report* at n.432.

[46] *Ninth Annual Report* ¶62. Echostar claims provision of local channels makes DBS service competitive with cable service. Sixty percent of DirecTV subscribers purchase the local channel package.

[47] *See* Comments of Scottsboro (Alabama) Electric Power Board ("SEPB") in the *Notice of Inquiry* in CS Docket No. 01129, at 5, Appendix B (Aug. 3, 2001) ("SEPB Comments"). In a surrounding community with no competition, the incumbent offered 150 channels for $77.90. *See also, In re Annual Assessment of the Status of Competition in the Market for Delivery of Video Programming,* CS Docket No. 01-129, Comments of Knology, Inc. to the Notice of Inquiry, 4-5 (filed late, Nov. 20, 2001); *In re Applications for Consent to the Transfer of Control of Licenses Comcast Corporation and AT&T Corporation, Transferors to AT&T Comcast Corporation, Transferee,* MB Docket No. 02-70, RCN Telecom Services, Inc., Written *Ex Parte* Comments in Response to Comcast (filed Aug. 27, 2002); *In re Applications for Consent to the Transfer of Control of Licenses Comcast Corporation and AT&T Corporation, Transferors to AT&T Comcast Corporation, Transferee,* MB Docket No. 02-70, RCN Telecom Services, Inc., Written *Ex Parte* and Accompanying Declaration (filed Aug. 14, 2002).

are being increased to offset the discounted price offered in the competitive neighborhood.

Although the reasons may not be clear, the results are: cable prices go down when there is wireline competition; cable prices do not go down when there is no wireline competition or when there is competition only from non-wireline providers. Any legislative attempt to reduce cable rates should focus on encouraging wireline competition. Any legislative reform of programming requirements should examine how cable operators may be using control of programming to discourage competition before considering how to give cable operators more control over programming.

H. FCC Policy Implementation Has Led to Unreasonable Rates and is Impeding Competition.

The FCC has not adopted regulations that ensure reasonable rates. The FCC has ignored absurd consequences and been generally unresponsive on consumer issues. And the FCC is permitting cable operators to abuse their monopoly power in a manner that harms competition for cable and broadband services. Additional Congressional oversight of the FCC is necessary to promote the wireline competition necessary to produce lower cable rates.

I. FCC Rate Regulation Rules Do Not Ensure Reasonable Rates.

An entire hearing could be, and should be, devoted to the numerous ways in which the FCC has failed to establish or interpret rate regulation rules in a manner that ensures reasonable rates for subscribers. Here are but a few examples:

- **Advertising Revenues Do Not Offset Costs.** Regulated rates are calculated to permit the operator to earn a reasonable profit from operation of the cable system. The FCC rate formula permits the operator to recover system operation costs from subscribers, but prohibits offsetting costs with any revenues earned from selling advertising on the system. For example, in 2002, subscribers paid over $10 billion in regulated rates for basic service. Cable operators collected an additional $2.8 billion in ad sales—i.e., 25% to 26% of what they recovered in basic rates—but none of the $2.8 billion was used to reduce the regulated basic rate.[48]
- **Operators Are Permitted to Collect 11.25% Interest.** An operator estimates its costs for the year and calculates a projected rate. At the end of the year, if the operator charged less than its actual costs, the operator can recover the difference plus an FCC-mandated *11.25% interest* rate from subscribers. However, if subscribers are owed refunds, under the FCC rules, the operator pays the I.R.S.-mandated rate, which is currently 6%.[49]
- **Operators Are Permitted to Inflate Aggregated Equipment Rates.** Congress permitted operators flexibility to calculate equipment rates at any level,[50] *e.g.,* by franchise, region, state, company-wide, etc., but the FCC implementing rules do not require any consistency within these calculations. Thus, for example, an operator determined that equipment costs were higher to serve a specific cluster of Ohio communities than the aggregate equipment costs for the entire state. The operator then calculated the equipment rates for those Ohio communities using only the higher costs and excluded the remaining lower cost areas. But when the operator calculated the rates for the rest of the state, it included the higher cost clustered communities in its calculations, thus increasing the aggregate rates for the rest of the state as well.[51]

J. FCC Inaction Impedes Local Government Efforts to Ensure Reasonable Rates.

FCC inaction and delays make rate regulation less effective, encourage operators to use the FCC appeals process as a means for running out the clock, and ultimately

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[48] *Ninth Annual Report* at Table 4. Table 4 has been attached as an Appendix to this testimony; *2002 Cost Report* at Table 1. Table 1 has been attached as an Appendix to this testimony. Basic Service is 38.0% of combined $28.492 million in 2002 Basic Service Tier and Cable Programming Service Charges, based on 2001 Average Monthly Rates of $12.84 for Basic Service Tier and $20.91 for Cable Programming Service. "Advertising sales" as used herein refers to all non-cable revenues, which includes $2.503 billion in advertising revenues and $284 million in home shopping network commissions for 2002. *See Texas Coalition of Cities For Utility Issues v. FCC,* 324 F.3d 802 (5th Cir. 2003).

[49] FCC Form 1240, available at http://www.fcc.gov/mb/mbform.html; 47 C.F.R. § 76.942(e).

[50] 47 U.S.C. § 543(a)(7)(A).

[51] Declaration of Garth Ashpaugh at ¶¶ 17-22, attached as Exhibit C to *Errata to Opposition to Appeal of Local Rate Order, Time Warner v. Miami Valley Cable Council,* (filed Dec. 6, 2002), available upon request.

deny subscribers the protection from unreasonable rates that Congress intended. For example:

- The FCC does not require the cable operator to refund overcharges if the FCC considers the overcharge to be *de minimis.*[52]
- After 1996, the FCC arbitrarily decided to dismiss any pre-1996 complaints regarding non-basic tier rates on grounds that the 1996 Act would deregulate non-basic tier rates *beginning in 1999.*[53] The final irony is, the reason there were any pre-1996 complaints still unresolved after deregulation of the non-basic tier, was because the FCC had not ruled on these appeals in a timely fashion. For example:
  - In a survey of FCC rate orders issues in 2000, the average time between the filing of rate order appeal and the release of an FCC order was 63.7 months—*more than five years!*[54]
  - On April 16, 2003, the FCC finally remanded for further evidence two rate orders originally appealed on September 21, 1995.[55]
- In 2002, the Enforcement Bureau sua sponte overturned a 1999 Cable Bureau Order rejecting an operator's refund plan. Instead, the Enforcement Bureau accepted the refund the operator thought it owed and dismissed the case on grounds that it was not worthwhile to issue a new refund order (since, post-deregulation of non-basic tiers, the cable operator would be able to raise non-basic service rates to recover the amount of any basic service refund ordered).[56] In effect, the FCC let the cable operator run out the clock and subscribers ended up footing the bill.

K. The FCC Creates Unreasonable Rates By Refusing to Revise Rate Regulation Rules to Prevent Absurd Results.

In some instances, an original FCC interpretation of federal law may create absurd results because of changed market circumstances, or unscrupulous application by operators. In almost no instance has the FCC reviewed its policy to determine whether the FCC policy continues to further the goal of Congress to ensure reasonable rates. For example:

Boston Effective Competition & the LEC Test. In 1996, Congress permitted effective competition to be declared when a local exchange carrier ("LEC"), i.e., local telephone service provider, began providing video programming service. This LEC test did not require any specific system build-out or subscriber penetration benchmarks to be met. In 1998, against a backdrop of seemingly limitless telecommunications capital financing, the FCC decided to accept franchise agreements with build-out requirements as showing that competition was present everywhere in a community, in lieu of requiring the entire LEC system to be built-out. In 2001, the Cable Bureau declared effective competition to exist in Boston based on a franchise granted to RCN. The City asked the FCC to reconsider, providing evidence that RCN was available in only a few of the City's neighborhoods, its financing had dried up, and that RCN would not be able to meet the franchise benchmarks. The City suggested that in the changed telecommunications climate, franchise agreements could not be substitutes for actual build-outs. In 2002, the FCC affirmed the effective competition decision, reasoning that RCN's financial troubles would simply mean that it might take an extra year to build-out its system. One month after the FCC decision, RCN asked the City to convert its franchise agreement into an OVS license without a build-out requirement. The City residents no longer have the ben-

[52] *See, e.g., In re King Video Cable Company Valley Springs, California, Benchmark Filing to Support Cable Programming Service Price,* Memorandum Opinion and Order, 10 FCC Rcd. 1707, ¶8 (1995); *In re King Video Cable Company Jackson, California,* Memorandum Opinion and Order, 10 FCC Rcd. 1706, ¶8 (1995).

[53] *See, e.g., In re Prestige Cable TV, Order Dismissing Rate Complaints,* Order, 12 FCC Rcd. 21,103, ¶4 (1997).

[54] Based on an audit of all Cable Service Bureau decisions related to enforcement of, 47 U.S.C. 623(c) Regulation of Unreasonable Rates, as reported in the Federal Communications Commission Record between January 1, 2000, and December 31, 2000. Of 36 reported decisions, 7 did not specifically mention the date of the initial complaint or date of order granting review of Local Franchising Authority decision.

[55] *In re TCI of Pennsylvania, Inc., Appeals of Local Rate Orders of the City of Pittsburgh, Pennsylvania,* CSB-A-0181 & CSB-A-0304, Memorandum Opinion and Order, DA 03-1151 (rel. Apr. 16, 2003) available at http://hraunfoss.fcc.gov/edocs_public/attachmatch/DA-03-1151A1.doc.

[56] *In re Marcus Associates Application for Review,* Order, File No. EB-02-TC-087 (2002), available at http://hraunfoss.fcc.gov/edocs_public/attachmatch/DA-02-3546A1.doc.

efit of rate regulation, and RCN does not serve many more neighborhoods than it did in 2001.[57]

L. Local Government v. FCC Level of Service to Subscribers.

Local governments are concerned that the FCC is unnecessarily collecting fees from subscribers to cover the cost of regulation no longer performed by the FCC, while simultaneously cutting the revenue streams of the local governments which now have greater franchise administration costs and needs for revenue streams.

In 1994, Congress required regulatory agencies to recover the cost of regulation from the regulated industries. At the height of rate regulation, the FCC calculated its costs as $0.49 per subscriber.[58] The FCC no longer regulates the CPST, no longer has a Cable Bureau, and there are 9.1 million more subscribers than there were in 1994; in effect, the FCC added $33.7 million to subscribers' bills in 2002 in return for little to no cable rate regulation.[59]

In contrast, local governments now regulate more companies in the public rights-of-way, and assist consumers with more complaints about more services. Yet through its *Cable Modem Order,* for 2002, the FCC permitted cable operators to use the public rights-of-way to generate an additional $5.6 billion in cable modem revenues, while simultaneously reducing the rent paid by cable modem providers to local governments by $280 million.

Consider the experience of Montgomery County, MD, with just under 206,000 cable subscribers, as an example of the misallocation of resources and revenues:[60]

- The FCC collected just over $100,000 in regulatory fees from Montgomery County cable subscribers; Montgomery County collected $600,000 less from cable operators in lost cable modem franchise fees.
- Among 68.8 million cable subscribers nationwide, the FCC handled 2143 complaints and inquiries about cable rates and billing, i.e., about 3 billing and rate complaints or inquiries per 100,000 subscribers. Montgomery County's cable office handled 1107 cable rate and billing complaints and inquiries, i.e., about 500 per 100,000 subscribers.
- Among the 6.6 to 7.4 million cable modem subscribers, the FCC handled 26 complaints and inquiries about cable modem service for the entire year, or 4 complaints and inquiries per million cable modem subscribers. Among 35,000 cable modem subscribers, Montgomery County handled 396 complaints and inquiries about cable modem service, or 1 per 100 cable modem subscribers.

M. The FCC Should Prevent, Not Promote, Cross-Subsidization.

The FCC's rate regulation rules are harming not only subscribers, but broadband competition as well. First, the FCC's rate regulation rules force cable subscribers to subsidize broadband deployment by cable operators. Under the FCC's rate regulation and equipment rules, cable operators have been permitted to recover the cost of upgrading their systems by raising the regulated rates of all basic subscribers.[61] These upgrades have enabled cable operators to provide Internet access and telephone service, and the FCC rate regulation rules permit cable operators to raise the rates of basic subscribers to pay for these upgrades, regardless of whether the customer subscribes to anything other than basic cable.

Second, the FCC's rate regulation rules are not just resulting in higher cable rates for basic subscribers; the FCC's rules are also providing a built-in rate subsidy to cable system operators, thus providing the cable industry with an artificial cost advantage over DSL and other competitive broadband providers. In contrast to cable rate regulation, in the mid-90s the FCC did not permit the telephone companies to increase the federally-controlled rates of basic telephone subscribers to recover the

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[57] *In re Cablevision of Boston, Inc., Petition for Determination of Effective Competition,* Application for Review of Determination of Effective Competition *in re* Cablevision of Boston, Inc. (filed Aug. 20, 2001); *In re Cablevision of Boston, Inc., Petition for Determination of Effective Competition, Application for Review,* Memorandum Opinion and Order, 17 FCC Rcd. 4772 (2002); Open Video System Certification Application of RCN BecoCom, LLC (filed April 18, 2002), *available at* http://www.fcc.gov/mb/ovs/rcnbos.doc.

[58] 47 U.S.C. § 159(a); 47 C.F.R. § 1.1155; *In re Implementation of Section of the Cable Television Consumer Protection and Competition Act of 1992: Rate Regulation,* Fourth Order on Reconsideration, 9 FCC Rcd. 5795, ¶¶ 9, 12, nn.28, 35 (1994) ("*Fourth Reconsideration Order*").

[59] *Third Report* at App. B Table 1; *Ninth Annual Report* at App. B Table B-1.

[60] These comparisons are based on 2002 Quarterly Report data released by the FCC's Consumer and Governmental Affairs Bureau, available at http://www.fcc.gov/cgb, and from complaint report information available upon request from the Montgomery County Office of Cable and Communications Services.

[61] *See, e.g., In re Social Contract for Time Warner,* Memorandum Opinion and Order, 11 FCC Rcd. 2788 (1995).

cost of providing video service over phones lines (*i.e.,* "video dial tone" service).[62] Today, cable modem has twice the number of subscribers and almost three times the number of access lines as ADSL.[63] By permitting one industry, but not another, to cross-subsidize from its captive rate payers, the FCC is manipulating competition between different forms of broadband service in a manner that Congress did not authorize.

Finally, because the FCC rules permit cable operators to charge more than they could in a competitive market—and the FCC has done nothing to encourage wireline competition to cable systems—there will always be room for the cable operator to offer a discount on basic cable rates (something that should not be possible if the FCC regulated rate was producing the rate that would be offered in a competitive market). Thus, cable operators are offering discounts on video programming cable service as a promotional benefit to encourage purchase and installation of cable modem service. These higher cable system build-out fees and cable-cable modem cross-market promotions may provide additional explanations as to why cable service rates continue to increase.

Local governments urge Congress to increase its administrative oversight of the FCC to eliminate practices that hinder efforts to achieve reasonable subscriber rates and practices that hinder competition.

CONCLUSION

Local governments act as: trustees, owners, and managers of valuable public property, mediators among competing uses of the public right-of-way, economic development agencies in promoting deployment of broadband facilities, users of extensive communications resources, developers and promoters of broadband applications, and protectors of consumer services and privacy.

Congress should act to protect these many vital roles of local government and in so doing Congress will also protect consumers. Specifically, Congress should:

- Clarify the cable modem service is a cable service subject to Title VI thereby ensuring cable modem consumers privacy and consumer protection
- Congress should also:
  - Require operators to disclose actual programming costs.
  - Review whether the 1994 à la carte tier pricing rules lead to lower rates before implementing à la carte pricing in 2003.
  - Instruct the FCC to implement rate regulation rules in a manner that prohibits unreasonable rates, eliminates absurd results, and reflects today's competitive markets.

Table 4: Cable Industry Revenue and Cash Flow: 1998-2002

From In re Annual Assessment of the Status of Competition in the Market For the Delivery of Video Programming, MB Docket No. 02-145, Ninth Annual Report, 17 FCC Rcd 26,901, (2002)("Ninth Annual Report") at 15.

	1998 Total	1999 Total	98-99 % Change	2000 Total	99-00 % Change	2001 Total	00-01 % Change	2002 Total	2001-2002 % Change
Basic Subscribers (mil.)	66.1	67.3	1.8%	68.5	1.8%	68.6	0.1%	69	0.6%
Revenue Requests (mil.)	—	—	—	—	—	—	—	—	—
Basic Service and CPST Tiers	$21,831	$23,135	6.0%	$24,729	6.9%	$27,031	9.3%	$28,492	5.4%
Premium (Pay) Tiers	$4,758	$4,696	-1.3%	$5,115	8.9%	$5,617	9.8%	$5,533	-1.5%
Pay-Per-View	$514	$721	40.3%	$751	4.2%	$993	32.2%	$1,143	15.1%
Local Advertising	$1,675	$2,000	19.4%	$2,430	21.%	$2,430	0.0%	$2,503	3.0%
Home Shopping	$175	$205	17.1%	$239	16.6%	$260	8.8%	$284	9.2%
Advanced Analog and Digital Tier	$445	$919	106.5%	$1,088	18.4%	$2,365	117.4%	$3,379	42.9%

[62] *See e.g., In re Telephone Company-Cable Television Cross-Ownership Rules,* CC Docket No. 87-266 and RM-8221, 10 FCC Rcd 244, 247 (1994), *available at* http://www.fcc.gov/searchtools.html, "Search For Filed Comments ECFS," DA/FCC Number "94-269."

[63] *June 2002 High Speed Report* at Tables 3 and 4.

Table 4: Cable Industry Revenue and Cash Flow: 1998-2002—Continued

From In re Annual Assessment of the Status of Competition in the Market For the Delivery of Video Programming, MB Docket No. 02-145, Ninth Annual Report, 17 FCC Rcd 26,901, (2002)(''Ninth Annual Report'') at 15.

	1998 Total	1999 Total	98-99 % Change	2000 Total	99-00 % Change	2001 Total	00-01 % Change	2002 Total	2001-2002 % Change
High-Speed Internet Access, Cable Teleph. & interactive svcs.	$133	$542	307.5%	$1,164	114.8%	$2,835	143.6%	$5,602	97.6%
Equipment and Install	$2,631	$2,424	-7.9%	$2,451	1.1%	$2,463	0.5%	$2,491	1.1%
Total Revenue (mil.)	$32,162	$34,642	7.7%	$37,967	9.6%	$43,994	15.9%	$49,427	12.3%
Revenue Per Subscriber	$486.57	$514.74	5.8%	$554.26	7.7%	$641.31	15.7%	$716.33	11.7%
Operating Cash Flow (mil.)	$14,900	$15,597	4.7%	$15,674	1.1%	$16,683	5.8%	$18,806	12.7%
Cash Flow Per Subscriber	$225.42	$231.75	2.8%	$230.13	-0.7%	$243.19	5.7%	$272.55	12.1%
Cash Flow/Total Revenue	46.3%	45.0%	-2.8%	41.5%	-7.8%	37.9%	-8.7%	38.0%	0.3%

Appendix B, Table B-1: Assessment of Competing Technologies

From In re Annual Assessment of the Status of Competition in the Market For the Delivery of Video Programming, MB Docket No. 02-145, Ninth Annual Report, 17 FCC Rcd 26,901, (2002)(''Ninth Annual Report'') at 75.

Technology Used	June-98	June-99	June-00	June-01	June-02
(1) TV Households	98,000,000	99,400,000	100,801,720	102,184,810	105,444,330
Percent Change	1.03%	1.43%	1.41%	1.37%	3.19%
(2) MVPD Households	76,634,200	80,882,411	84,423,717	87,830,074	89,890,641
Percent Change	4.06%	5.54%	4.38%	4.60%	1.79%
Percent of TV Households	78.20%	81.37%	83.75%	86.42%	85.25%
(3) Cable Subscribers	65,400,000	66,690,000	67,700,000	68,500,000	68,800,000
Percent Change	1.95%	1.97%	1.51%	1.18%	0.00%
Percent of MVPD Total	85.34%	82.45%	80.19%	77.99%	76.54%
(4) MMDS Subscribers	1,000,000	821,000	700,000	700,000	490,000
Percent Change	-9.09%	-17.90%	-14.74%	0.00%	-30.00%
Percent of MVPD Total	1.30%	1.02%	0.83%	0.80%	0.55%
(5) SMATV Subscribers	940,000	1,450,000	1,500,000	1,500,000	1,600,000
Percent Change	-19.14%	54.26%	3.45%	0.00%	6.67%
Percent of MVPD Total	1.23%	1.79%	1.78%	1.71%	1.78%
(6) HSD Subscribers	2,018,200	1,783,411	1,476,717	1,000,074	700,641
Percent Change	-7.15%	-12.07%	-17.20%	-32.28%	-29.94%
Percent of MVPD Total	2.65%	2.20%	1.75%	1.14%	0.78%
(7) DBS Subscribers	7,200,000	10,078,000	12,987,000	16,070,000	18,240,000
Percent Change	42.66%	39.97%	28.86%	23.74%	13.66%
Percent of MVPD Total	9.40%	12.46%	15.38%	18.30%	20.29%
(8) OVS Subscribers	66,000	60,000	60,000	60,000	60,000
Percent Change	2100.00%	-9.09%	0.00%	0.00%	0.00%
Percent of MVPD Total	0.09%	0.07%	0.07%	0.07%	0.07%

Notes:
(i) Some numbers have been rounded.
(ii) The total number of MVPD households is likely to be somewhat less than the given figure since some households subscribe to the services of more than one MVPD. See 1994 Report, 9 ICC Rcd at 7480. However, the number of households subscribing to more than one MVCP is expected to be low. Hence the given total can be seen as a reasonable estimate of the number of MVPD households.
(iii) The decline in OVS subscribers since 1998 reflects the conversion of some OV4 systems to franchised cable systems over the last three years.

Appendix C, Table C-1: MSO Ownership in National Video Programming Services

From In re Annual Assessment of the Status of Competition in the Market For the Delivery of Video Programming, MB Docket No. 02-145, Ninth Annual Report, 17 FCC Rcd 26,901, (2002)(''Ninth Annual Report'') at 80-82.

Programming Service	Launch Date	MSO Ownership (%)
Action Max	Jun-98	AOL Time Warner (100)

Appendix C, Table C-1: MSO Ownership in National Video Programming Services—Continued

From In re Annual Assessment of the Status of Competition in the Market For the Delivery of Video Programming, MB Docket No. 02-145, Ninth Annual Report, 17 FCC Rcd 26,901, (2002)(''Ninth Annual Report'') at 80-82.

Programming Service	Launch Date	MSO Ownership (%)
American Movie Classics	Oct-84	Cablevision (60)
Animal Planet	Oct-96	Liberty Media (39.2), Cox (19.7)
(a) Max	May-01	AOL Time Warner (100)
Black STARZ!	Feb-97	Liberty Media (100)
Canales (6 digital channels) *	Oct-98	Liberty Media (90)
Cartoon Network	Oct-92	AOL Time Warner (100)
Cinemax	Aug-80	AOL Time Warner (100)
CNN	Jun-80	AOL Time Warner (100)
CNN en Espanol	Mar-97	AOL Time Warner (100)
CNN Headline News	Jan-82	AOL Time Warner (100)
CNN International	Jan-95	AOL Time Warner (100)
CNNfn	Dec-95	AOL Time Warner (100)
Comedy Central	Apr-91	AOL Time Warner (50)
Court TV	Jul-91	Liberty Media (50), AOL Time Warner (50)
Discovery Channel	Jun-85	Liberty Media (50), Cox (24.6)
Discovery Civilization	Oct-96	Liberty Media (25), Cox (12.3)
Discovery en Espanol	Aug-98	Liberty Media (50), Cox (24.6)
Discovery Health	Jul-98	Liberty Media (50), Cox (24.6), Comcast (20)
Discovery HD Theatre	Jun-03	Liberty Media (50), Cox (24.6), Comcast (20)
Discovery Home & Leisure	Oct-96	Liberty Media (50), Cox (24.6)
Discovery Kids	Oct-96	Liberty Media (50), Cox (24.6)
Discovery Science Channel	Oct-96	Liberty Media (50), Cox (24.6)
Discovery Wings: The Aviation and Adventure Channel	Jul-98	Liberty Media (50), Cox (24.6)
E! Entertainment	Jun-90	Comcast (50)
Encore	Apr-91	Liberty Media (100)
Encore Action	Sep-94	Liberty Media (100)
Encore Love Stories	Jul-94	Liberty Media (100)
Encore Mystery	Jul-94	Liberty Media (100)
Encore True Stories	Sep-94	Liberty Media (100)
Encore WAM! America's Youth Network	Sep-94	Liberty Media (100)
Encore Westerns	Jul-94	Liberty Media (100)
5Star Max	May-01	AOL Time Warner (100)
FoxSports (2) channels	Various	Cablevision (50)
FoxSports Latin America	Nov-96	Liberty Media (50)
G4 Video Gaming Network	Jun-02	Comcast (94)
GEMS International Television	Apr-93	Liberty Media (100)
Golf Channel	Jan-95	Comcast (91)
Hallmark Channel (formerly Odyessy)	Oct-93	Liberty Media (32.5)
HBO	Nov-72	AOL Time Warner (100)
HBO Latino	Nov-00	AOL Time Warner (100)
HBO 2	Oct-98	AOL Time Warner (100)
HBO Signature	Oct-93	AOL Time Warner (100)
HBO Comedy	May-99	AOL Time Warner (100)
HBO Family	Dec-96	AOL Time Warner (100)
HBO Zone	May-99	AOL Time Warner (100)
Home Shopping Network	Jul-85	Liberty Media (20)
In Demand	Nov-85	Comcast (55), AOL Time Warner (33), Cox (11)
Independent Film Channel	Sep-94	Cablevision (60)
International Channel	Jul-90	Liberty Media (90)
More MAX	Aug-91	AOL Time Warner (100)
Movie Plex	Oct-94	Liberty Media (100)
Much Music USA	Jul-94	Cablevision (75)
Outdoor Life Network	Jul-95	Comcast (100)
OuterMax	May-01	AOL Time Warner (100)
Ovation: The Arts Network	Apr-96	AOL Time Warner (4.2)
PIN (Product Information Network)	Apr-94	Cox (45)
Prevue Channel	Jan-88	Liberty Media (51)
QVC	Nov-86	Comcast (57), Liberty Media (43)
Sci-Fi Channel	Sep-92	Liberty Media (20)
Sneak Prevue (TV Guide)	May-91	Liberty Media (12)
Starz!	Feb-94	Liberty Media (100)
Starz! Cinema	May-99	Liberty Media (100)

Appendix C, Table C-1: MSO Ownership in National Video Programming Services—Continued

From In re Annual Assessment of the Status of Competition in the Market For the Delivery of Video Programming, MB Docket No. 02-145, Ninth Annual Report, 17 FCC Rcd 26,901, (2002)(''Ninth Annual Report'') at 80-82.

Programming Service	Launch Date	MSO Ownership (%)
Starz! Family	May-99	Liberty Media (100)
Starz! Theater	Mar-96	Liberty Media (100)
Style	May-99	Comcast (50)
TBS	Dec-76	AOL Time Warner (100)
TLC (The Learning Channel)	Nov-80	Liberty Media (50), Cox (24.6)
Thriller Max	Jun-98	AOL Time Warner (100)
Turner Classic Movies	Apr-94	AOL Time Warner (100)
USA Network	Apr-80	Liberty Media (20)
Viewers Choice 1-10 and Hot Choice (11 multiplexed channels).	Nov-85	Cox (20), AOL Time Warner (17)
WE	Jan-97	Cablevision (60)
WMAX	May-01	AOL Time Warner (100)

Sources: NCTA, Directory of Program Services, Cable Developments 2002 at 29-141.
Liberty Media Corp. at http://www.libertymedia.com/our affiliates/video programming.htm

Table 1: Average Monthly Rate, by Component (Competitive and Non-Competitive Groups Combined)

From In re Statistical Report on Average Rates for Basic Service, Cable Programming Service, and Equipment, Report On Cable Industry Prices, MM Docket No. 92-266, 17 FCC Rcd 6301, Table 6 (2002) (''2002 Cost Report'') at 8.

	July 1, 2002	July 1, 2001	12-Month Change	Percent Change
Basic service tier (BST)	$12.57	$12.84	$0.27	2.1%
Cable programming service tier (CPST)	$18.88	$20.91	$2.03	10.8%
Total programming services (BST and CPST)	$31.45	$33.75	$2.30	7.3%
Equipment (set-top box and remote control)	$2.97	$3.24	$0.27	9.1%
Programming and equipment combined	$34.42	$36.99	$2.57	7.5%
Number of local channels	14.1	14.5	0.4	2.8%
Number of satellite channels	42.2	44.9	2.7	6.4%
Total channels on BST and CPST	56.3	59.4	3.1	5.5%
Programming rate per satellite channel	$0.797	$0.801	$0.00	40.5%
Programming rate per channel overall	$0.591	$0.600	$0.009	1.5%

Table 6: Comparison between Competitive Strata and the Noncompetitive Group

From ''2002 Cost Report'' at 11.

Date	Wireline Overbuild	DBS Overbuild	LEC	Low Penetration	Municipal	Non-Competitive
Average Monthly Rate						
July 1, 2001	$34.03	$37.13	$35.03	$34.30	$24.35	$37.13
July 1, 2000	$31.45	$34.25	$32.55	$32.57	$23.40	$34.54
Number of Channels						
July 1, 2001	56	53.3	65.3	52.9	51.4	59.3
July 1, 2000	52.7	46.5	62.4	49.5	50.8	56.2
Average Rate per Channel (Programming Only)						
July 1, 2001	$0.587	$0.727	$0.489	$0.663	$0.447	$0.603
July 1, 2000	$0.578	$0.761	$0.483	$0.674	$0.437	$0.594

"THE APPROPRIATE REGULATION OF TRANSMISSION UNDERLYING INCUMBENT LEC BROADBAND INTERNET ACCESS"

SUBMITTED BY ALLEGIANCE TELECOM, CONVERSENT COMMUNICATIONS AND TIME WARNER TELECOM TO

THE HOUSE ENERGY AND COMMERCE COMMITTEE SUBCOMMITTEE ON TELECOMMUNICATIONS AND THE INTERNET

JULY 21, 2003

In the *Wireline Classification NPRM*,[1] the FCC suggested that it should classify the transmission underlying incumbent LEC broadband Internet access as "telecommunications" that is not subject to Title II. The purpose of this paper is to explain why such an approach would be unlawful, and why continuing to treat incumbent LEC transmission inputs as telecommunications services is not inconsistent with the conclusions reached in the *Cable Modem Order*. This paper takes no position as to the merits of the *Cable Modem Order*. It addresses that order solely for the purpose of analyzing whether the conclusions reached therein, assuming the FCC does not alter them sometime in the future, compel the FCC to classify the transmission inputs used in incumbent LEC broadband Internet access as Title I services.

EXECUTIVE SUMMARY

The proposal in the *NPRM* must be understood in the broader context of the requirements and goals of the Communications Act, with which it is in almost complete conflict. As the Second Circuit explained when reviewing the Commission's *Computer I* orders, the Commission's "primary responsibility" under Title II is to ensure that transmission services are offered by common carriers on just and reasonable and not unjustly or unreasonably discriminatory rates, terms and conditions. Subsequent *Computer Inquiry* decisions were adopted on the same basis. Yet by deregulating incumbent LEC provision of an entire class of services without regard to incumbent LEC market power (and incumbent LECs possess such market power in many if not all relevant markets for broadband service), the Commission would give the incumbent LECs free reign to charge unreasonably high rates and engage in

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[1] *See Appropriate Framework for Broadband Access to the Internet over Wireline Facilities*, Notice of Proposed Rulemaking, 17 FCC Rcd 3019 (2002) ("*Wireline Classification NPRM*" or "*NPRM*").

unreasonable discrimination. This is true for both broadband transmission and narrowband voice service. Such a result would constitute a fundamental abdication of responsibility by the FCC.

In addition, the 1996 Act Amendments make it clear that the Commission may not rely on regulatory classification as a means of relieving the incumbent LECs of existing regulations. Prior to the adoption of the 1996 Act Amendments, there was considerable doubt that the terms of the 1934 Act gave the FCC the authority to reclassify or forbear from regulation of transmission services provided by common carriers. Congress clarified this issue by adopting Section 10 in 1996. That provision gives the FCC extensive forbearance power over regulations or statutory provisions applicable to telecommunications carriers or telecommunications services. Section 10 is clearly the mechanism chosen by Congress for the elimination of Title II regulation. The Commission must therefore satisfy the requirements of Section 10(a) (including an assessment of whether a requirement is necessary to ensure just, reasonable and not unreasonably discriminatory rates) before it may eliminate common carrier regulation applicable to broadband inputs. Indeed, in Section 706 Congress specifically directed the FCC to rely on this framework for determining whether deregulation is an appropriate means of spurring broadband investment. Moreover, as the D.C. Circuit held in vacating the use of a separate affiliate as a means of allowing the merged SBC-Ameritech to escape the requirements of the Act, the Commission may not evade Section 10 by relying on strained interpretations of the statute.

The forbearance test in Section 10(a) (*i.e.*, that the requirement is not necessary to ensure that a service is provided on rates, terms and conditions that are just, reasonable, and not unjustly discriminatory, that it is not necessary to protect consumers, and that forbearance is in the public interest) cannot be met here. This is true with regard to requirements whose purpose is to

constrain incumbent LEC market power (such as Sections 201, 202 and 251), because, again, the incumbent LECs unquestionably have that market power. Moreover, even in the absence of that market power, the incumbent LECs could not meet the Section 10 test for the statutory requirements that advance policy goals unrelated to controlling market power (*e.g.,* universal service, CPNI, access for the disabled, slamming protections, and -- to the extent Section 10 applies to it -- CALEA).

Nor could the Commission impose any of these requirements pursuant to its ancillary jurisdiction if the transmission inputs were classified as Title I "telecommunications." The Commission may exercise ancillary jurisdiction over interstate or international communications by wire or radio only to the extent necessary to advance the policy goals established in a specific grant of authority elsewhere in the statute. Yet there could be no such policy goals, because the Commission would otherwise have retained the Title II classification. But even if this were not the case, the Commission still could not impose Title II-like regulations on a Title I service because the statute states that "[a] telecommunications carrier [like the incumbent LECs] shall be treated as a common carrier under this Act only to the extent that it is engaged in providing telecommunications services." 47 U.S.C. § 153 (44). The plain meaning of this restriction and the Supreme Court's interpretation of a very similar provision in its *Midwest Video II* decision preclude the imposition of Title II regulation on non-Title II services offered by incumbent LECs. The only appropriate way to impose such requirements is pursuant to the direct exercise of jurisdiction by classifying a service as a telecommunications service.

Furthermore, while it has been suggested that continuing to classify incumbent LEC broadband inputs as a telecommunications service requires the Commission to revisit its *Cable Modem Declaratory Order*, this is not the case. In support of this suggestion, it has been

asserted that, where an information service is provided *via any* facility used in any part as a telecommunications carrier facility, the *Computer II* rules require that the transmission underlying the information service be made available as a stand-alone Title II offering. To the extent that this rule was not applied to cable modem services provided over facilities used in part to provide telecommunications services (such as local telephone service), the concern is that there is no basis for treating the incumbent LECs differently. But the purpose of requiring the unbundling of transmission used to provide an information service was to prevent the abuse of market power in violation of the core Title II policies embodied in Sections 201 and 202. These policy considerations continue to require the "unbundling" of incumbent LEC transmission inputs because reclassifying incumbent LEC broadband would allow incumbent LECs to exploit their unquestioned market power in numerous ways and in numerous different markets. It may be that the Commission will reach the same conclusion some day with regard to the transmission underlying cable modem service, but no party apparently even attempted to make that showing in the *Cable Modem Order* proceeding. In the absence of such a showing, the Commission's decision not to impose *Computer II*-like requirements on cable modem services was not inconsistent with past precedent.

DISCUSSION

I. The Commission's *Computer Inquiry* Orders Were Adopted To Address The Commission's "Primary Responsibility": Ensuring Carrier Compliance With The Core Requirements Of Title II.

The history of the *Computer Inquiries* is crucial to understanding the FCC's responsibilities in addressing wireline broadband Internet access services. For four decades now, the Commission has undertaken a highly successful effort to draw regulatory lines between enhanced/information services and basic/telecommunications services. The FCC has set out two policy reasons for doing so. First, the agency wanted to prevent regulatory creep, that is, to

avoid extending regulation to information services (primarily computer applications such as data processing) that utilize the public telephone network but that are competitively supplied. Second, and particularly relevant here, the Commission set up a regulatory framework for the "basic" side of the regulatory line in direct pursuit of its Title II responsibilities. The *Computer Inquiries* have been an extended effort to permit dominant carriers to participate in these new complementary markets while ensuring just, reasonable and not unreasonably discriminatory access to the public telecommunications network.

The FCC's Title II responsibilities were found to be threatened in two distinct ways by dominant carrier entry into the adjacent information service markets. First, the FCC perceived that the ratepayers of regulated monopoly services could be harmed by a carrier's diversion of resources to the unregulated markets, both in terms of misallocation of costs and revenues as a means of evading price controls as well as misdirection of resources necessary to maintain a high quality, state-of-the-art network for the provision of regulated services. Second, the FCC was concerned that firms that were both institutional customers of the monopoly telephone companies as well as competitors could be harmed through discrimination strategies exploiting incumbent LEC control of bottleneck facilities.

As the FCC explained in adopting its *Computer I* rules, "[t]he dangers" associated with carrier entry into the data processing business "relate primarily to the alleged ability of common carriers to favor their own data processing activities by discriminatory services, cross subsidization, improper pricing of common carrier services, and related anticompetitive practices and activities."[2] The Commission stated in particular its concern that the "sale of data processing

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[2] *Regulatory And Policy Problems Presented By The Interdependence Of Computer And Communication Services And Facilities*, Final Decision and Order, 28 FCC 2d 267, ¶ 12 (1971) ("*ComputerI Order*").

services by carriers should not adversely affect the provision of efficient and economic common carrier services." *Computer I Order* at ¶ 9. The Second Circuit upheld the *Computer I* rules because they were "based upon the primary charge of the Commission that its carriers provide efficient and economic service to the public;" were "logically directed at eliminating the potential hazards to efficient and economic phone service which is clearly the Commission's *primary responsibility* and interest here;" and were "aimed at the protection of efficient telephone service to the public by eliminating the possibility of a diversion of facilities to other purposes."[3]

Computer II was decided on this basis as well. The Commission justified the regulatory line between basic and enhanced services drawn in *Computer II* as an exercise of its responsibilities under Title II:

> This structure enables us to direct our attention to the regulation of basic services and to assuring nondiscriminatory access to common carrier facilities by all providers of enhanced services.[4]

The structural separation requirements of the *Computer II* were expressly designed to further this goal by ensuring that common carriers did not bundle network capabilities with enhanced services to evade regulation. Thus, as a result of the separation requirements, "the benefits of any improvements introduced into [the Bell System's] transmission facilities to accommodate the needs of its subsidiary would become available to all users of the underlying facilit[ies]."[5] These

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3 *GTE Service Corp. v. FCC*, 474 F.2d 724, 730-32 (2d Cir. 1973) (emphasis added).

4 *Amendment of Section 64.702 of the Commission's Rules and Regulations*, Final Decision, 77 FCC 2d 384, ¶ 116 (1980) (*"Computer II Final Decision"*).

5 *Amendment of Section 64.702 of the Commission's Rules and Regulations*, Memorandum Opinion and Order, 84 FCC 2d 50, ¶ 78 (1980) (*"Computer II Reconsideration Order"*). *See also Application of AT&T for Authorization Under Section 214 of the Communications Act of 1934, as amended, to Install and Operate Packet Switches*, Memorandum, Opinion, Order and Authorization, 94 FCC 2d 48, ¶ 11 (1983), *(AT&T (BPSS 214))*:

decisions were upheld on appeal as again consistent with the bedrock requirements of Title II. In *Computer and Communications Industry Assn. v. FCC,* the court expressly upheld

> [t]he Commission's announced policy...to promote the 'efficient utilization and full exploitation of the interstate telecommunications network.' This can best be accomplished, in the Commission's view, by regulating the rates of only those activities *clearly* within the scope of Title II.
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> * * *
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> Given th[e] potentially symbiotic relationship between competitive and monopoly services, the agency charged with ensuring monopoly rates are just and reasonable can legitimately exercise [ancillary] jurisdiction over the provision of competitive services.[6]

These policies and concerns were also the foundation of *Computer III.* Although the FCC lifted the separation requirements in that proceeding, it did so on the basis that accounting and unbundling requirements could less intrusively assure achievement of the key objective of ensuring access to the public network:

> [O]ur CEI and Open Network Architecture requirements are specifically designed to ensure that all enhanced services providers, including the BOCs' unregulated operations, receive equal access to the BOCs' basic facilities, and our information disclosure requirements give enhanced service providers timely technical and marketing information in order to utilize those basic facilities.[7]

On appeal, the Ninth Circuit reversed the FCC's decision because it had not adequately explained how removal of the structural separation requirements of *Computer II* could address the problems of cross-subsidies and assure reasonable rates for basic ratepayer services.[8] On

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> In our *Computer II* decisions, we have sought to establish a rational and enduring demarcation between basic and enhanced services. We also have sought, as an important public interest objective, to ensure that innovation and improvements will continue to occur in the regulated basic network, and that broadly available basic services will continue to evolve as technology evolves.

6 *Computer and Communications Industry Assn. v. FCC*, 693 F.2d 198, 210-11, 213 (D.C. Cir. 1982).

7 *Amendment of Sections 64.702 of the Commission's Rules and Regulations (Third Computer Inquiry)*, Report and Order, 104 FCC 2d 958, ¶ 97 (1986) ("*Computer III*").

8 *See California v. FCC*, 905 F.2d 1217 (9th Cir. 1990).

remand, the FCC reviewed and strengthened a variety of accounting safeguards which were "geared to protecting ratepayer interests."[9]

The Commission affirmed this policy as recently as last year, in its reaffirmation of the *Computer II* unbundling requirements:

> [T]he separate availability of the transmission service is fundamental to ensuring that dominant carriers cannot discriminate against customers who do not purchase all the components of a bundle from the carriers themselves.[10]

Significantly, the Commission gave assurance that its own cost allocation requirements and accounting safeguards would protect captive ratepayers, both interstate and intrastate, from being forced to foot the bill for new and unregulated incumbent LEC services. *Id.* Again, the just and reasonable and non-discrimination mandates of Title II were the central focus of the Commission's regulation of incumbent LEC provision of enhanced services.

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9 *Computer III Remand Proceedings: Bell Operating Company Safeguards and Tier I Local Exchange Company Safeguards*, Report and Order, 6 FCC Rcd 7571, ¶ 48 (1991) ("*Remand Order*"). On appeal, this aspect of the *Remand Order* was upheld, although other aspects of the *Computer III* regime were overturned. *California v. FCC*, 39 F.3d 919 (9th Cir. 1994) (vacating decision to replace structural separation with behavioral safeguards). While the 9th Circuit was willing to defer to the Commission's 'predictive judgment' ("That the efficacy of these measures is yet to be proven is not in and of itself a basis for finding the FCC's decision arbitrary and capricious"), *id.* at 926, there is considerable evidence that the accounting safeguards have in fact proved inadequate. Although the FCC decision to terminate the 1999 audit proceedings (in which the Bureau believed substantial problems with RBOC accounting had been uncovered) as part of adoption of the CALLS plan was upheld on appeal, it has been the subject of considerable criticism. *See* Scott Woolley, *Shortchanged*, Forbes.com (May 12, 2003), *available at* http://www.forbes.com/forbes/2003/0512/082.html.

10 *Policy and Rules Concerning the Interstate, Interexchange Marketplace Implementation of Section 254(g) of the Communications Act of 1934, as amended, 1998 Biennial Regulatory Review -- Review of Customer Premises Equipment And Enhanced Services Unbundling Rules In the Interexchange, Exchange Access And Local Exchange Markets*, Report and Order, 16 FCC Rcd 7418, ¶ 44 (2001) ("*Bundling Order*") *citing Cellular Bundling Order*, 7 FCC Rcd at 4028, ¶¶ 1, 13, 23.

II. The Terms Of The Communications Act, Relevant Case Law, And Marketplace Realities Confirm That The Policy Objectives Underlying The *Computer Inquiries Must* Remain A Central Focus Of Commission Policy.

The questions raised in the *Wireline Classification NPRM* regarding the appropriate classification of incumbent LEC transmission inputs under the terms of the 1996 Act raise the *exact same questions* as those addressed by the Commission in the *Computer Inquiries*. Moreover, given the incumbent LECs' overwhelming and persisting market power over the provision of those inputs as well as the serious threat of regulatory evasion, the Communications Act requires that the answer to the classification questions remain the same: incumbent LEC transmission inputs must remain Title II services.

In the 1996 Act, Congress added the defined terms "telecommunications service," "telecommunications carrier," and "telecommunications" to the Communications Act, and it imposed extensive new Title II obligations on "telecommunications carriers." *See* 47 U.S.C. §§ 153(43), (44), & (46).[11] In contrast, the Title II provisions that preceded the 1996 Act (mostly adopted in the 1934 Act itself) apply to "common carrier" service. *See e.g.*, 47 U.S.C. §§ 153(10), 201-203. Nevertheless, the Commission has concluded that, "[t]he legislative history of the 1996 Act indicates that the definition of telecommunications services is intended to clarify that telecommunications services are common carrier services."[12]

Accordingly, in determining whether a firm is acting as a "telecommunications carrier," the Commission has applied the test established in *NARUC I*[13] for determining whether a firm is

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[11] A telecommunications carrier is an entity that provides telecommunications service, except that aggregators of telecommunications service are not to be classified as telecommunications carriers. *See* 47 U.S.C. § 152(44).

[12] *Cable & Wireless*, 12 FCC Rcd 8516, ¶ 13 (1997) ("*Cable & Wireless*").

[13] *National Assoc. of Regulatory Util. Commissioners v. FCC*, 525 F.2d 630 (D.C. Cir. 1976) ("*NARUC I*").

a common carrier.[14] The basic question under this test is whether the transmission service is offered indifferently to all customers (*i.e.*, "for a fee directly to the public or to such classes of users as to be effectively available to the public," 47 U.S.C. § 153(46)) such that customers can transmit information of their choosing without change in form or content (*i.e.*, "between or among points specified by the user, of information of the user's choosing, without change in the form or content of the information as sent and received" 47 U.S.C. § 153(43)). *See Cable & Wireless*, ¶ 14. Under *NARUC I* and FCC precedents, a firm is deemed to provide common carrier/telecommunications service (herein referred to as telecommunications service) if (1) there is a regulatory compulsion, *i.e.*, the FCC deems it necessary to require the entity to make such an offering in order to meet the policy objectives of the Communications Act, or (2) a firm volunteers such an offering. *See NARUC I*, 525 F.2d at 642; *Cable & Wireless*, ¶ 14.

There can be no doubt that there is a pre-existing, statutory compulsion attached to the incumbent LECs' basic transmission capabilities and services. Congress made the crucial policy decision in 1934 and again in 1996 that there is a need for extensive governmental oversight over the provision of transmission service. That judgment was based on the view that the provision of these services was and is part of the critical infrastructure of the U.S. economy. Further, the market failures and externalities that characterized the provision of these services required governmental intervention. The Commission has in fact repeatedly acknowledged that broadband services are subject to Title II.[15]

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[14] The D.C. Circuit has upheld that this conclusion as a reasonable interpretation of the statute. *See Virgin Islands Telephone Corp. v. FCC*, 198 F.3d 921, 926-27 (D.C. Cir. 1999).

[15] *See Deployment of Wireline Services Offering Advanced Telecommunications Capability*, 13 FCC Rcd 24011, ¶ 35 (1998); *Review of Regulatory Requirements for Incumbent LEC Broadband Telecommunications Services*, Memorandum Opinion & Order, 17 FCC Rcd 27000 (2002). Incumbent LECs had in fact tariffed such offerings to ISPs. *GTE DSL Order, supra.* Incumbent LEC "gateway services," the precursor to today's DSL offerings, were well understood to fall under this framework as

The public utility conventions that attach to such services are rigorous, at least conceptually. They extend to all aspects of the carrier communications business. Title II requires common carriers to "furnish [their] service[s] upon reasonable request," 47 U.S.C. § 201(a), to make "[a]ll charges, practices, classifications and regulations for [those] service[s] . . . just and reasonable," 47 U.S.C. § 201(b), and declares unlawful any "unjust or unreasonable discrimination" in the terms of services. 47 U.S.C. § 202 (a). These carriers must also establish physical interconnection with other carriers upon the Commission finding that such interconnection is in the public interest. 47 U.S.C. § 201(a).

The Commission is given extensive authority to ensure that these requirements are met. Most significantly, the Commission can review a carrier's tariffs showing the rates, terms and conditions for each of its services and can postpone the service offering indefinitely. 47 U.S.C. §§ 203-205. It can preclude such offerings altogether, if found unlawful, and it can prescribe new terms of service to which the carrier will be bound. *Id.* A carrier may also be compelled to provide services under Section 406. 47 U.S.C. § 406. The FCC may also review and declare unlawful all contracts with other carriers relating to traffic covered by the Act. 47 U.S.C. § 211.

Title II imposes significant obligations on carrier *facilities* as well. In order to ensure against unnecessary expenditures, Section 214, 47 U.S.C. § 214, prohibits a carrier from undertaking construction without prior approval by the Commission. It also prohibits a carrier from removing that facility from service until and unless the Commission is able to determine that "neither present nor future public convenience or necessity will be adversely affected by its

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well. *See Bell Atlantic Telephone Companies Offer of Comparably Efficient Interconnection to Providers of Gateway Service*, Memorandum Opinion and Order, DA 88-1512, ¶ 11 (1988) ("As Bell Atlantic argues, because gateway service is an enhanced service, it is not regulated by the Commission. .... Bell Atlantic's provision of the underlying basic services are, of course, the subject of regulation (including CEI requirements)....").

discontinuance." *Id.* Moreover, a carrier may be compelled to undertake new construction to "provide itself with adequate facilities for the expeditious and efficient performance of its service as a common carrier...." 47 U.S.C. § 214(d).

In 1996, Congress compelled even more extensive duties, in particular by enacting the requirements of 251(c). As the Supreme Court observed:

> The Telecommunications Act of 1996, P.L. 104-104, 110 Stat 56, (1996 Act or Act) fundamentally restructures local telephone markets...[I]ncumbent LECs are subject to a host of duties intended to facilitate market entry. Foremost among these duties is the LEC's obligation under 47 U.S.C § 251(c) (1994 ed., Supp. II) to share its network with competitors.[16]

These obligations include interconnection, unbundling, and resale (among others) and must be carried out on just, reasonable and non-discriminatory terms. 47 U.S.C § 251(c)(2), (3), (4).

The "regulatory compulsion" to deal, then, is not merely present; it is the foundation of Title II itself. The facilities used to provide wireline Internet access services are the very facilities that Congress directed the FCC to regulate and over which the ILECs have market power. The *Wireline Classification NPRM* itself defines the proceeding by reference to Internet access services "over the existing and future infrastructure of the traditional telephone network." *Wireline Classification NPRM* at ¶ 1 n.1. To suggest that carriers should escape these longstanding, fundamental common carrier obligations by an administrative act of reclassifying the services and facilities is to suggest that the basic telephone network is no longer in need of regulatory oversight.

Moreover, the unilateral act of a carrier to choose to bundle broadband and Internet access cannot somehow defeat the regulatory agency responsibility:

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16 *AT&T v. Iowa Utilities Board*, 525 U.S. 366, 371 (1999).

> Since the Computer II regime, we have consistently held that the addition of the specified types of enhancements (as defined in our rules) to a basic service neither changes the nature of the underlying basic service when offered by a common carrier nor alters the carrier's tariffing obligations, whether federal or state, with respect to that service.[17]

For example, "[i]t is plain. . .that an incumbent local exchange carrier cannot escape Title II regulation of its residential local exchange service simply by packaging that service with voice mail;"[18] and the long distance service offerings of the Bell Companies do not relieve them of the obligation to continue to provide exchange access on just, reasonable and non-discriminatory terms. Similarly, the local loop and the associated incumbent LEC market power does not vanish when additional services are offered over it (even if the *Triennial Review Order* seems substantially based on the hope that it would).

In sum, the regulatory compulsion established in Title II means that the Commission may not allow incumbent LECs to simply withdraw and/or withhold stand-alone tariffed or UNE offerings, unless the policies of Title II are adequately served by substitute offerings. The agency is statutorily bound by Congress to prevent this result. And because the FCC has repeatedly observed the incumbent LECs' market power over these Title II services and facilities, there are not, by definition, adequate substitute offerings to which consumers and competitors can turn.

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17 *Filing and Review of Open Network Architecture Plans (Phase I)*, Memorandum Opinion and Order, 4 FCC Rcd 1, ¶ 274 (1988).

18 *Federal-State Joint Board on Universal Service*, Report to Congress, 13 FCC Rcd 11501, ¶ 60 (1998) ("*Report to Congress*").

A. Reclassification Of Incumbent LEC Transmission Inputs Would Allow Incumbent LECs To Evade The Core Requirements Of Title II As Applied To Broadband.

The incumbent LECs are clearly dominant in the provision of broadband facilities and services, most importantly DS1, DS3 and similar loops, needed to serve business customers. Broad reclassification of the underlying transmission of all "wireline broadband internet access services" and facilities would impermissibly extend deregulation to the services and facilities that the FCC continues to regulate due to market power. Indeed, the incumbent LECs themselves have implicitly conceded the relevance of market power by uniformly defending reclassification based on the (meritless) argument that they lack market power over transmission inputs needed for broadband Internet access.[19]

It should be noted at the outset that the suggestion of a relevant market comprised solely of broadband transmission packaged with Internet access is incorrect. A particular downstream application (here, Internet access) by no means defines the upstream (transmission) market. Basic voice service is basic voice service whether the carrier's operators are speaking English or French. Similarly, the differences between the transmission underlying broadband Internet access and the service category of "special access" or "unbundled high capacity loops" are legal fiction. These are distinctions of no significance for the market power analysis.[20] Given in particular the FCC's persistent efforts to regulate high-capacity special access where the incumbent LECs' market power endures, it would be arbitrary to select some fictive group of

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[19] *See* SBC Comments, CC Dkt. 02-33 (May 3, 2002) at 20-24; Verizon Comments CC Dkt. 02-33 (May 3, 2002) at 11-12; BellSouth Comments CC Dkt. 02-33 (May 3, 2002) at 15-16; Qwest Comments CC Dkt. 02-33 (May 3, 2002) at 16-17.

[20] Indeed, GTE's initial tariffed offering of ADSL was accepted by the Commission as special access service. *GTE Telephone Operating Cos.*, 13 FCC Rcd 22466 (1998) ("*GTE DSL Order*").

high-capacity services (transmission inputs for broadband Internet access) for deregulation. These services are provided over the same facilities as special access.

The Commission's continuing regulation of incumbent LEC special access services is expressly based on the incumbent LECs' market power over underlying facilities in all geographic markets and without regard to the bandwidth of the high-capacity transmission circuit.[21] Even where the FCC has granted pricing flexibility, it has done so based upon *predictions* of alternative supply.[22] The Commission has thus appropriately continued to classify the incumbent LECs as dominant in these services. *Id.*[23] Notably, the FCC also expressly excluded special access from the scope of the proceeding in which it is assessing the extent of

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21 *See Regulatory Treatment of LEC Provision of Interexchange Services Originating in the LEC's Local Exchange Area and Policy and Rules Concerning the Interstate, Interexchange Marketplace,* CC Docket Nos. 96- 149 & 96-61, *Second Report and Order, CC Docket No. 96-149 and Third Report and Order in CC Docket No. 96-61*, 12 FCC Rcd 15,756 (1997) (*LEC Classification Order*), *recon. denied* 14 FCC Rcd 10,771 (1999); *Implementation of the Accounting Safeguards Under the Telecommunications Act of 1996,* CC Docket No. 96-150, Report and Order, 11 FCC Rcd 17,539 (1996) recons. 14 FCC Rcd 11,396 (1996); *second recons.* 15 FCC Rcd 1161 (2000); *Implementation of the Non-Accounting Safeguards of Section 271 and 272 of the Communications Act of 1934, as amended,* CC Docket No. 96-149, 11 FCC Rcd 21,905 (1996); *recons.*, 12 FCC Rcd 2297 (1997) *second recons.*, 12 FCC Rcd 8653 (1997) *aff'd sub nom. Bell Atlantic Telephone Companies v. FCC,* 131 F.3d 1044 (D.C. Cir. 1997), *third recons.* 14 FCC Rcd 16,299 (1999); *Performance Measurements and Standards for Interstate Special Access Services, et al.*, CC Docket No. 01-321, Notice of Proposed Rulemaking, 16 FCC Rcd 22,117 (2001).

22 *Access Charge Reform*, Fifth Report and Order and Further Notice of Proposed Rulemaking, 14 FCC Rcd 14221 (1999) ("*Pricing Flexibility Order*"), *affd WorldCom, Inc. v. FCC*, 238 F.3d 449 (D.C. Cir. 2001):

> [Some] forms of regulatory relief ..., if granted prematurely, might enable price cap LECs to (1) exclude new entrants from their markets, or (2) increase rates to unreasonable levels. Accordingly, as a condition for granting further pricing flexibility, we require incumbent LECs to show that markets are sufficiently competitive both to warrant pricing flexibility to enable incumbent LECs to respond to competition and to discourage incumbents from either excluding new entrants or raising rates to unreasonable levels

Id. at ¶ 68.

23 As recently as May 19, the FCC has raised questions regarding the ability of the incumbent LECs to harm downstream markets by virtue of their market power in access services. *Section 272(f)(1) Sunset of the BOC Separate Affiliate and Related Requirements*, Further Notice Of Proposed Rulemaking, WC Dkt. No. 02-112, FCC 03-111 (*rel.* May 19, 2003).

incumbent LEC market power in the provision of broadband transmission services.[24] Even SBC has conceded that the Commission should continue to treat incumbent LECs as dominant in the provision of special access.[25]

Furthermore, the Commission has gathered large records of evidence over the past two years confirming incumbent LEC dominance in broadband or high-capacity loops without regard to whether those loops could be classified as "special access" and including those used to provide broadband Internet access services. This is especially clear with regard to business customers. For example, there is simply no basis for concluding that cable modem service (upon which the deregulatory initiative for incumbent LEC broadband Internet access is almost entirely based) is a substitute for the broadband services demanded by virtually any business customer. Cable modem service is rarely in the same geographic market and could never be considered to be in the same product market as the services demanded by business customers.[26]

> Cable modem service is generally not an option for many business locations. There are two reasons. First, cable systems typically do not pass business areas. Cable networks were constructed to provide cable television services to residential customers. Second, business users have reliability and security needs that cable modem service typically do not provide. By contrast, incumbent LEC

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24 *Review of Regulatory Requirements for Incumbent LEC Broadband Telecommunications Services, Notice of Proposed Rulemaking*, 16 FCC Rcd 22745, ¶ 22 (2001). This aspect of the *NPRM* reflects the incoherent nature of that proceeding since, again, if the incumbent LECs have market power over facilities when used to provide special access, they have the same market power when the same facilities are used to provide a different service.

25 *See* Letter from Jeffry A. Brueggeman, General Attorney, SBC Communications Inc. to Ms. Marlene H. Dortch, CC Dkt. No. 01-337 (May 29, 2003) at 4 (p.3 of the attached presentation).

26 Even with respect to residential services,

> [t]he geographic dimension of the market is quite significant. The Commission has previously considered the broadband market as local. Consumers require service at their fixed locations. The availability of wireless on the other side of the hill, or cable in the adjacent community, is not a substitute for DSL at their residence. Therefore, the geographic scope of broadband service markets can be quite narrow.

Declaration Of Daniel Kelley, *supra*, at 15.

> copper networks are ubiquitous; their technology is inherently reliable and secure.... .[27]

In addition, cable systems lack the capacity to serve large numbers of business customers in need of high speed service. Further, they are engineered specifically to address their primary application -- video programming -- so that, for example, the asymmetric upstream/downstream capacities make them ill-suited for many business applications.[28] Wireless services, including 3G applications, similarly can not accommodate business user applications offered over telco facilities.[29] The severe limitations of fixed wireless and satellite are also well-documented.[30]

The only viable alternatives for business customers are competitive wireline facilities, and entry here is so limited (due to problems associated with obtaining building access, access to public rights-of-way, the absence of adequate demand to justify construction -- this is almost always the case with small- and medium-sized business customers -- and customer demands that service be delivered before construction can be completed), and so critically dependent upon access to incumbent LEC facilities (either in the form of high-capacity unbundled loops or special access), that CLECs cannot reasonably be said to constrain incumbent LEC strategic behavior at all.[31] Most recently, evidence has been submitted to the FCC demonstrating that the

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27 Declaration Of Daniel Kelley at 19 (filed May 3, 2002) (attached to Joint Comments Of Worldcom, Inc., The Competitive Telecommunications Association, and The Association For Local Telecommunications Services in this proceeding).

28 HAI Report: The Technology and Economics Of Cross-Platform Competition In Local Telecommunications Markets, WorldCom Comments, CC Docket 01-338, at 35 (Submitted as Attachment A to the Joint Comments of Worldcom, Inc., the Competitive Telecommunications Association, and the Association For Local Telecommunications Services in this proceeding (filed May 3, 2002).

29 HAI Report at 50-51.

30 *See* Reply Comments of Allegiance Telecom, CC Dkt. No. 01-337 (Apr. 22, 2002) at 6.

31 Declaration of Robert D. Willig (filed May 3, 2002) (submitted with Comments of AT&T Corp. in this proceeding); *See* Declaration of Robert D. Willig, CC Docket No. 10-337, at l 27-31 (filed March 1, 2002) (attached to Comments of AT&T).

incumbent LECs are earning substantial margins for special access.[32] Significantly, the incumbent LECs have been able to escalate prices at the same time they are expanding sales. *Id.*

Some competitors have built end user connections to some larger business customers. The ILECs have tried to exploit this fact by arguing that such construction is possible for any business customer. Compounding the confusion, the ILECs have repeatedly argued that the only two broadband product markets are those for ASDL/cable modem services on the one hand and higher capacity connections on the other.[33] In fact, while it is true that CLECs have been able to construct high-capacity end user connections in some situations (most commonly circuits of DS3 capacity and above), obstacles associated with building access, customer demands for immediate provisioning and the limited scope of network footprints prevent CLECs from constructing even loops with DS3 capacity and above in a significant number of cases. Furthermore, as Allegiance has demonstrated, customer demand for broadband falls into at least three distinct product markets: (1) ADSL/cable modem; (2) integrated access, T-1, HDSL and equivalents; and (3) circuits with DS3 equivalent capacity and above (including those used for ATM, Frame Relay, and similar services).[34] Thus even if it were always possible for CLECs to build their own DS3 loops (which it is not), this fact does not mean that such construction is at all feasible when CLECs are serving a different market (those demanding integrated access, T-1, HDSL and equivalents) with lower margins and completely different technical requirements. As it happens,

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32 *See AT&T's Petition for Rulemaking to reform Regulation of Incumbent Local Exchange Carrier Rates for Interstate Special Access*, Petition of AT&T, RM No. 10593 (filed Oct. 15, 2002).

33 *See* Quest comments, CC Dkt. No. 01-357 at 20-21; SBC Comments, CC Dkt. No. 01-337 at 30-31

34 *See* Allegiance Telecom Reply Comments, CC Dkt. No. 01-337 (Apr. 22, 2002) at 2-8.

it is even clearer in the integrated access, T-1, HDSL and equivalents market that loop construction is rarely possible.

Each incumbent LEC's unsupervised control over bottleneck facilities allows it not only to gouge customers, but also "increase[s] the duration of the entrenched firm's market power [and] increase[s] the incentive and ability ... to discriminate against its rivals, particularly with respect to the provision of advanced telecommunications services."[35] As the Commission has explained further:

> Because incumbent LECs . . . compete with other providers of advanced services, they have an incentive to discriminate against companies that depend on them for evolving types of interconnection and access arrangements necessary to provide new services to consumers. They also have the incentive to limit or control the development of new services to the extent new services compete with their current offerings. In addition, competitors often are totally dependent on incumbent LECs for last mile wireline access to end users.

Id. at ¶ 202. Both CLECs and ISPs are targets of this misconduct.

Thus, an FCC decision to allow incumbent LECs to offer transmission services bundled with information services without Title II regulation will permit incumbent LECs to raise prices paid by their customers, deny access to their competitors, and discriminate in favor of affiliated information service providers. Where the Commission has granted some relaxation of regulatory requirements for the retail services involved here, it has done so only upon the condition that:

> SBC's operating companies also will remain subject to dominant carrier regulation for the facilities and services ASI and its competitors use as inputs for their advanced services offerings, and ASI must continue to purchase inputs from SBC's operating companies on a non-discriminatory basis.[36]

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35 *Applications of Ameritech Corp., Transferor, and SBC Communications Inc., Transferee, for Consent to Transfer Control of Corporations Holding Commission Licenses and Lines Pursuant to Sections 214 and 310(d) of the Communications Act*, Memorandum Opinion and Order, 14 FCC Rcd 14,712, ¶ 5 (1999).

36 *Review of Regulatory Requirements for Incumbent LEC Broadband Telecommunications Services*, Memorandum Opinion and Order, 17 FCC Rcd 27000, ¶ 16 (2002).

Nor is it safe to assume that the Commission could continue to rely on unbundling requirements to check incumbent LEC market power. The Commission has already apparently substantially eliminated incumbent LEC unbundling obligations for fiber-fed, packetized high-capacity loops in the *Triennial Review*. But if the FCC were to here decide that the transmission capabilities underlying Internet access services are "telecommunications" rather than "telecommunications services," there is a significant legal risk that no remaining unbundling obligations would apply to facilities used solely for Internet access.

In fact, the most reasonable interpretation of the statute is that unbundling obligations apply to incumbent LECs to the extent that a *requesting carrier* seeks to use the facilities in question to provide a telecommunications service.[37] Whether the incumbent LEC itself uses the facilities in question exclusively for the provision of Title I (or other non-Title II) services should be irrelevant.

The source of the legal risk, however, is primarily that unbundling obligations in Section 251(c)(3) apply only to incumbent LECs. *See* 47 U.S.C. § 251(c). All facilities owned by an incumbent LEC cannot be considered subject to Section 251(c)(3). That provision is found in Title II, which applies (with very few exception) to telecommunications carriers only. The Act states that a "telecommunications carrier shall be treated as a common carrier . . . only to the extent that it is engaged in providing telecommunications services." 47 U.S.C. § 153(44). To

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[37] Section 251(c)(3) states that a requesting carrier may obtain UNEs from the incumbent LEC "for the provision of a telecommunications service." 47 U.S.C. § 251(c)(3). Moreover, the Act defines network element as "a facility or equipment used in the provision of a telecommunications service." *See id.* at § 153(29). Whether a facility is to be used "for" or "in" the provision of a telecommunications service should turn on whether the requesting carrier uses it for that purpose. The Commission essentially reached this conclusion with regard to unbundled dark fiber. *See Implementation of the Local Competition Provisions of the Telecommunications Act of 1996*, Third Report and Order, 15 FCC Rcd 3696, ¶ 327 (1999) (concluding that dark fiber is a UNE even though the fiber in question is not actually used by the incumbent LEC to provide a telecommunications service, but rather is "customarily employed" by the incumbent LEC for this purpose).

the extent that it uses a facility exclusively to provide Title I/private carriage services, an incumbent LEC could (and no doubt would) argue that it cannot be treated as a telecommunications carrier, let alone an incumbent LEC, with regard to those facilities.

The D.C. Circuit can be understood to have accepted this view in its decision upholding incumbent LEC unbundling obligations applicable to DSL service.[38] In that case, Qwest asserted that it could only be subject to requirements applicable to an incumbent LEC to the extent it was acting as a LEC. It argued further that loops used to provide xDSL could not be subject to Section 251(c)(3), because the statutory definition of a LEC is an entity engaged in the provision of telephone exchange service and exchange access services, and DSL is (according to Qwest) neither. *See id.* at 693-94. The Commission argued in response that an entity that provides either telephone exchange service or exchange access service meets the statutory definition of a LEC (and in Qwest's case an incumbent LEC) with regard to those services as well as other telecommunications services provided by the same entity. *See id.* at 694. The Court upheld this aspect of the Commission's reasoning. *See id.* at 694-96. There is a substantial risk that this decision would be interpreted in the future to mean that an incumbent LEC is only subject to Section 251(c)(3) with regard to facilities it uses to provide telecommunications services.

In all events, it should be obvious to the Commission that the incumbent LECs will use arguments such as this to delay CLEC access to network elements by pursuing aggressive litigation and regulatory advocacy while at the same time denying access to the inputs (as Verizon has done with its trumped up "no-facilities" claims).[39] Under the guise of providing

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[38] *See WorldCom, Inc. v. FCC*, 246 F.3d 690 (D.C. Cir. 2001).

[39] The incumbent LECs have already argued in response to the *Wireline Classification NPRM* that unbundling obligations would not apply to facilities used solely to provide Title I or information services. *See* SBC Comments, CC Dkt. No. 02-33 (May 3, 2002) at 32; Verizon Comments, CC Dkt. No. 02-33 (May 3, 2002) at 32-33.

regulatory certainty to spur investment, the Commission would introduce enormous ambiguity that incumbent LECs will exploit to stunt competitive investment.

B. Reclassification Of Incumbent LEC Transmission Inputs Would Allow Incumbent LECs To Evade The Core Requirements Of Title II As Applied To Narrowband Voice Services.

Independent of the implications for broadband service itself, the principles of Title II require the Commission to treat the transmission underlying broadband Internet access as a Title II offering because of the implications for narrowband services. Reclassification of broadband transmission inputs would offer the incumbent LECs numerous opportunities to act on their powerful incentives to charge unreasonably high prices and to discriminate unreasonably among voice customers.

Wireline broadband services are provided over the same facilities over which the incumbent LECs have enduring market power, most especially local voice and exchange access. DSL lines and T-1 lines, for example, are nothing more than technical enhancements of the local loop. As the Commission has explained, "a non-broadband line, like a standard telephone line, that has been conditioned so that it is capable of more than 200 kbps would constitute broadband."[40] The replacement of copper with hybrid fiber-copper loops also does nothing to alter the underlying economies of scale that cause incumbent LEC to retain control over bottleneck facilities (although the *Triennial Review Order* is apparently based on the hope that it will). With advances in VoIP, broadband connections will likely soon become ready substitutes for primary telephone lines because customers will be able to receive voice and Internet access over this same packet-switched connection (and this is already the case with many businesses).

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[40] *See Inquiry Concerning the Development of Advanced Telecommunication 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,* Report, 14 FCC Rcd 2398, ¶ 20 (1999).

As SBC's Chief Technology Officer explained, "technology is going in a direction that ultimately will have services commingled. So whether they're data or digital or voice, ultimately I believe those will be commingled."[41]

This poses a very serious problem for regulation of voice service. For example, assume that there is strong demand for Title I broadband offerings that integrate voice and Internet access over a packetized loop and that such a product is viewed by subscribers as clearly superior to traditional circuit-switched voice service (not an unrealistic assumption). In geographic markets where the incumbent LEC does not have competition in the provision of this service from firms with their own broadband loop facilities (as explained, this is generally true for all but the largest business customers), there would be no way to ensure that rates for the voice service are just, reasonable, and not unreasonably discriminatory. Competition would not place any pressure on the incumbent LEC because competitors could not obtain broadband loops either under tariff or (because of the Triennial Review and/or the consequences of reclassification discussed above) as a UNE. The sole means of obtaining end user connections would be pursuant to private contract, and incumbent LECs would of course have no incentive to agree to reasonable terms and conditions for access.

Regulators could try to limit the incumbent LECs' opportunities to maximize their monopoly profits by regulating the retail rate for the voice service. But that would prove to be almost impossible. To begin with, the integrated broadband offering would presumably be unregulated in its entirety. So to the extent that voice service was offered in that context, it would be free of any regulation, retail or otherwise. This situation would give the incumbent LECs the opportunity to evade regulation of narrowband voice service, because they could

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[41] *See* Telecommunications Reports, June 17, 2002.

charge any price for the integrated offering (including the voice service of course) that the relevant elasticities of demand would permit. Moreover, any attempt to try to ensure that voice service remains available at a reasonable price by requiring incumbent LECs to offer it on a regulated stand-alone basis is unlikely to have the intended effect. The incumbent LECs would have virtually endless opportunities to provide degraded access to stand-alone voice customers by designing innovations solely for the integrated offering, providing discriminatory repair and maintenance, and by misallocating the costs of the unregulated voice service to the regulated rate base (a strategy that is virtually impossible to prevent given the overwhelming percentage of joint and common costs at issue).[42]

There is nothing new about any of these observations. The Commission made almost precisely these points fully 16 years ago when implementing the *Computer Inquiry* rules:

> Packet switching is heading rapidly for integration with facilities for conventional telephone service. We probably can treat the present [waivers with respect to non-integrated packet switching] independently of the state and federal regulatory treatment of conventional telephone service. *We cannot realistically do so when both groups of services are integrated, given that local exchange telephone service and use of local exchange facilities for interstate access presently represents a near-monopoly. * * * To do so might lead to premature deregulation of conventional telephone services not because there is effective competition therefor, but because they are to be integrated with packet switching technology.*[43]

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42 The burdens on basic ratepayers are already in evidence. In Verizon's recent announcement to lower certain DSL prices dramatically, its Vice Chairman and President Lawrence Babbio explained openly that "[o]ur new pricing is made possible because we're building on the infrastructure investments we've already made," Verizon News Release, May 13, 2003, *available at* http://newscenter.verizon.com/proactive/newsroom/release.vtml?id=80217. And a recent SBC ad explains "the SBC local phone companies bear an enormous investment load for building and maintaining local networks, including expensive upgrades for high-speed Internet service." Comm. Daily, May, 16, 2003, at 7.

43 *Petitions for Waiver of Section 64.702*, 100 FCC 2d 1057, ¶ 77 (1985). The Commission granted, subject to significant conditions, the BOCs request to perform conversion from asynchronous protocols to standard X.25 packet-switch network protocols in facilities located in their central offices.

In short, misclassification opens a gaping hole in the FCC's ability to protect consumers and the competitive process from monopoly gauging or other forms of strategic behavior. This radical outcome, in effect an abdication by the Commission of its primary responsibilities under Title II, surely cannot be what Congress intended.

The situation would be very different and the opportunities for incumbent LEC anticompetitive conduct much more limited if the Commission continued to regulate the transmission underlying broadband Internet access as a Title II service. Most importantly, such regulation would require that the incumbent LECs provide the underlying transmission inputs on regulated terms (as UNEs or under tariff) to competitors. This would allow competitors to enter the market for integrated Internet access and voice services, thereby diminishing the need to regulate incumbent LEC retail offerings. Title II requires nothing short of this result.

III. The Commission Cannot Forbear From Regulating The Transmission Underlying Incumbent LEC Broadband Internet Access Unless And Until It Can Meet The Requirements Of Section 10.

The Commission's proposed definitional approach to determining whether incumbent LEC broadband inputs should be subject to the currently applicable Title II requirements is an impermissible end run around the requirements of Section 10. 47 U.S.C. § 160. That provision sets forth the standard the Commission *must* meet before forbearing from enforcing statutory and regulatory requirements otherwise applicable. *See id.* at § 160(a).[44]

Even prior to the adoption of the 1996 Act Amendments, there was significant doubt that the FCC could redefine the term "common carrier" as a means of removing Title II obligations.[45]

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[44] The full text of Section 10 is set forth in an appendix to this paper.

[45] *See AT&T v. FCC*, 572 F.2d 17 (2d Cir. 1978). *See generally* Phil Nichols, Note, *Redefining 'Common Carrier': The FCC's Attempt At Deregulation By Definition*, 1987 Duke L. Journal 501 (1987).

While the Commission has in the past prohibited Title II regulation of services that had been offered under tariff, none of these services constituted common carriage *per se* (*i.e.*, the transmission of the information of the customer's choosing without changing the form or content of the information).[46] In every case, the FCC had allowed the service in question to be offered under tariff solely because it was bundled with transmission services that were clearly common carrier services. Moreover, in the *Competitive Carrier* proceeding, the FCC had initially proposed to deregulate competitive provision of common carrier services through a definitional approach in instances where it believed regulation was unnecessary or counterproductive.[47] These efforts were abandoned and the FCC chose to test its forbearance authority directly, culminating in the Supreme Court's ruling that Title II lacked any such flexibility.[48]

The legal uncertainty as to whether and how the Commission could tailor the application of the Title II requirements to carriers that were subject to competition reflected the extent to which the terms of the 1934 Act had been overtaken by events. That Act was not designed to

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46 For example, the Commission had allowed carriers in the past to include CPE in their tariffs, but it had never classified the provision of CPE as common carriage. *See Computer II Final Decision* ¶ 172 ("the Commission has never regarded the provision of terminal equipment in isolation as an activity subject to Title II"). Its decision to detariff CPE simply reflected its conclusion that the sale of stand-alone CPE had always been a non-common carrier activity. Detariffing the provision of billing and collection was similarly based on the conclusion that these activities are not, by themselves, subject to Title II. *See Detariffing of Billing and Collection Services*, Report and Order, 102 FCC 2d 1150, ¶¶ 32-34 (1986). Finally, detariffing the provision and maintenance of inside wiring was based on the conclusion that installation and maintenance services require "individualized" service offerings that disqualify them from classification as Title II services and that the utility's network should be deemed to end at the customer's demarcation point (as with other utility offerings). *See Detariffing the Installation of and Maintenance of Inside Wiring*, Memorandum Opinion and Order, 3 FCC Rcd 1719, n.30 (1988); *Detariffing the Installation of and Maintenance of Inside Wiring*, Memorandum Opinion and Order, 1 FCC Rcd 1190, ¶ 16 (1986).

47 *See Policy and Rules Concerning Rates for Competitive Common Carrier Services and Facilities Authorizations*, Further Notice of Proposed Rulemaking, 84 FCC 2d 445 (1981).

48 *MCI Telecommunications Corp. v. AT&T*, 512 U.S. 218 (1994) (concluding that the FCC did not have the authority to forbear from enforcing tariff filing requirements applicable to carriers).

provide a framework for allowing market pressures to replace regulation. This is not surprising in light of the apparent assumption in 1934 that telephone service was a natural monopoly.

Congress explicitly resolved the uncertainty in this area by enacting Section 10 as part of the 1996 Act Amendments. That provision expressly authorizes the FCC to forbear from existing regulation pursuant to the standards set forth therein. It did not alter the FCC's ability to redefine common carriage, however. In fact, the Act's new definition of telecommunications services, along with its preservation of the definition of common carrier from the 1943 Act, unambiguously show that Congress intended to preserve traditional concepts of common carriage.[49] The Act provides no new authority to redefine these concepts.

Accordingly, Section 10 establishes the statutory mechanism chosen by Congress for forbearing from existing Title II regulation, and the Commission has very little ability to avoid its application. In *ASCENT v. FCC*,[50] for example, the D.C. Circuit ruled that the FCC cannot circumvent the limitations on forbearance authority set forth in Section 10 through strained interpretations of other statutory provisions. The FCC had sought to eliminate the application of Section 251(c) requirements to incumbent LEC advanced services by interpreting the definition of incumbent LEC to exclude an advanced service separate affiliate. In assessing the lawfulness of the agency's actions, the court quoted extensively from the FCC's determinations "that advanced services are telecommunications services like any others and may not be provided by an incumbent LEC unless the incumbent LEC complies with § 251(c)." [51] The court went on to

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[49] *See Virgin Islands Telephone Corp. v. Federal Communications Commission*, 198 F.3d 921 (D.C. Cir. 1999).

[50] *Association of Communications Enterprises v. FCC*, 235 F.3d 662 (D.C. Cir. 2001) ("ASCENT v. FCC").

[51] *Id.* at 664, *citing inter alia Deployment of Wireline Services Offering Advanced Telecommunications Capability*, 13 FCC Rcd 24012, ¶¶ 11, 66-67 (1998).

describe the FCC's finding "that it lacked the authority to forbear from applying §251(c) to advanced services" and further that exempting incumbent LECs' advanced services from these "market-opening obligations 'is at odds with the technology-neutral goals of the Act....'" *Id.* The court concluded that the Commission's attempted end run around these principles, and Section 10 more generally, was impermissible.

While *ASCENT v. FCC* dealt with stand-alone broadband, the Commission has concluded that "Congress intended the 1996 Act to maintain the *Computer II* framework" for services that integrate transmission and information service components.[52] Moreover, the Commission recently reaffirmed this conclusion in its *Bundling Order*. *See, supra*, n.11. An attempt now to redefine telecommunications services to exclude underlying broadband transmission capabilities from regulation when an incumbent LEC chooses to bundle them with information services rides roughshod on the legislative intent to continue the basic vs. enhanced dichotomy. Given these past rulings, it is highly unlikely that the FCC could convince a court that its proposal in the *NPRM* is anything other than an effort to evade Section 10.

The terms of Section 706 further support this conclusion. Section 706 states that, to the extent that the Commission seeks to encourage the deployment of advanced service capabilities by eliminating regulation, it should exercise its powers of "regulatory forbearance." The Commission has held that this is simply a reference to the Commission's authority under Section 10:

> Section 706(a) does not constitute an independent grant of forbearance authority or of authority to employ other regulating methods. Rather, we conclude that section 706(a) directs the Commission to use the authority granted in other

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[52] *Federal-State Joint Board on Universal Service,* 13 FCC Rcd 11501, ¶ 46 (1998).

> provisions, including the forbearance authority under Section 10(a), to encourage the deployment of advanced services.[53]

Thus, the provision in which Congress articulated the national policy for broadband specifically directs the Commission to apply the standards set forth in Section 10, not reclassification, as the appropriate means of reducing regulation as a means of spurring deployment.

There should also be no dispute that the Commission cannot meet the standards set forth in Section 10. To begin with, Section 10(d) prohibits the Commission from forbearing from the requirements of Section 251(c) until those provisions have been "fully implemented." 47 U.S.C. § 160(d). The Commission has not concluded (and could not conclude) that it has "fully implemented" Section 251(c). Yet, as discussed above, there is a significant chance that the Section 251(c)(3) unbundling obligations would not apply to transmission inputs classified as Title I telecommunications. Nor would the resale requirement in Section 251(c)(4) apply, because that provision applies only to "telecommunications services" provided by incumbent LECs. The resulting failure to enforce these requirements is by itself a violation of Section 10.

In addition, the Commission could not meet the other requirements of Section 10(a). That provision states that the Commission may forbear from enforcing a regulation or statutory provision only if it "is not necessary to ensure that the [terms of service] are just and reasonable and not unjustly or unreasonably discriminatory;" that "regulation … is not necessary for the protection of consumers" and that forbearance "is consistent with the public interest." As the FCC has specifically observed, a decision to forbear from regulating dominant carriers would

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[53] *Deployment of Wireline Services Offering Advanced Telecommunications Capability,* Memorandum Opinion and Order and Notice of Proposed Rulemaking, 13 FCC Rcd 24012, ¶ 69 (1998); *See also* Order on Reconsideration, 15 FCC Rcd 17044, ¶ 7 (2000) (affirming the Commission's previous decision that Section 706(a) does not constitute an independent grant of forbearance authority and denying petitions of Bell Atlantic and SBC to reconsider that decision).

require a comprehensive, disciplined analysis of market conditions.[54] As explained, any such analysis would yield the conclusion that the *Computer Inquiry* framework must continue to apply to the incumbent LEC transmission inputs.

But even if the Commission were to conclude that regulations designed to prevent abuse of market power were not necessary, applying a Title I classification would still be inappropriate. The 1996 Act Amendments (and CALEA) establish numerous regulatory obligations that serve social goals other than restraining market power. These obligations apply to "telecommunications services" or "telecommunications carriers." They therefore reflect Congress' intent that such obligations would apply to services long after the providers have lost their market power, as they do today, to long distance service, competitive local exchange service, and many other services that are subject to competition. Following are examples of statutory requirements that probably would no longer apply to incumbent LEC transmission inputs classified as Title I service.

- **Universal Service.** The problems a reclassification of incumbent LEC underlying transmission as Title I poses for universal service have been fairly comprehensively addressed in this proceeding, and there is no need to restate them here in any detail. It is clear that Title I classification will threaten broadband deployment for rural carriers that participate in NECA pooling,[55] will remove significant incumbent LEC revenues currently subject to universal service (unless the FCC changes the current contribution methodology), and will make it impossible for the transmission underlying incumbent LEC broadband Internet access to be eligible for federal universal service support[56]. In addition, while the subject has received less attention in this proceeding, it is important

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54 *See RBOC Petitions For Forbearance from Regulation as a Dominant Carrier,* Memorandum Opinion and Order, 14 FCC Rcd 19947 (1999).

55 *See, e.g.*, The Nebraska Independent Companies Comments, CC Dkt. 02-22 at 4-5; National Exchange Carrier Association ("NECA") , CC Dkt. 02-22 Comments at 2-4; National Rural Telecom Association Comments, CC Dkt. 02-22 at 16-18; Organization for the Promotion and Advancement of Small Telecommunications Companies ("OPASTCO") , CC Dkt. 02-22 Comments at 3-5; National Telecommunications Cooperative Association Comments, CC Dkt. 02-22 at 5-7.

56 *See* Comments of TWTC, CC Dkt. 02-22 at 25-26.

for the Commission to focus on the fact that reclassification would likely also eliminate incumbent LECs' obligation to provide broadband transmission to rural health care providers. 47 U.S.C. § 254(h)(1)(A). The statutory duty to serve rural health care providers applies only to "telecommunications services which are necessary for the provision of health care services." See 47 U.S.C. § 254(h)(1)(A).

- **CPNI.** The statutory limits placed on the use of customer proprietary network information ("CPNI") apply only to "a telecommunications carrier that receives or obtains [CPNI] by virtue of its provision of a telecommunications service." 47 U.S.C. § 222(c)(1). *See also* 47 U.S.C. § 222(h)(1) (defining CPNI as information relating to "use of a telecommunications service subscribed to by any customer of a telecommunications carrier"). Thus, the important privacy protections in Section 222 would be inapplicable if the transmission underlying incumbent LEC broadband Internet access were classified as a Title I service.

- **Access For The Disabled.** The requirement in Section 255 that services be made available to persons with disabilities applies only to telecommunications services. See 47 U.S.C. § 255(c). That provision would therefore not apply to transmission inputs classified as Title I services. This is inconsistent with the statutory policies underlying Section 255, because broadband Internet access would seem to offer promising ways to overcome the limitations that physical disabilities might otherwise impose.

- **Slamming.** Section 258 prohibits any "telecommunications carrier" from submitting or executing a change in a subscriber's telephone exchange or telephone toll service "except in accordance with such verification procedures as the Commission shall prescribe." 47 U.S.C. § 258(a). This provision reflects Congress' concern that carriers in a competitive market would engage in slamming that would directly harm subscribers. Yet if the Commission were to remove any Title II regulation of inputs to broadband Internet access, it might be impossible to police slamming where such broadband offerings are integrated with packet-switched telephone exchange and toll services.

The Commission would be hard-pressed to demonstrate that the policy goals underlying these requirements are not relevant to incumbent LEC broadband transmission inputs.

Finally, the Commission does not have any express authority to forbear from the requirements of CALEA, yet those may also not apply to Title I broadband. The Communications Assistance for Law Enforcement Act ("CALEA") applies by its terms to "telecommunications carriers," "providers of telecommunications support services" and manufacturers. *See* 47 U.S.C. § 1001 et seq. To qualify as a "telecommunication carrier" for purposes of CALEA, an entity must "engage in the transmission or switching of wire or

electronic communications as a common carrier for hire." 47 U.S.C. § 1001(8). It is hard to see how an incumbent LEC providing service on a private carrier could meet this definition. Nor would an incumbent LEC providing such a service qualify as a provider of "telecommunications support services" (defined as a "product, software, or service used by a telecommunications carrier for the internal signaling or switching functions of its telecommunications network") or as a "manufacturer" (an undefined term, but one whose normal meaning renders it inapplicable). It follows therefore that there is a significant risk that, by reclassifying the transmission underlying incumbent LEC broadband Internet access, the FCC would be abdicating its responsibility to implement CALEA. *See also* 47 U.S.C. § 229 (requiring the FCC to adopt rules implementing CALEA and referring to those rules as applicable to "common carriers").[57]

IV. The Commission Could Not Impose Title II-Like Requirements On Broadband Transmission Classified As Title I Service Pursuant To Its Ancillary Jurisdiction.

Even if the Commission did have the authority to reclassify broadband transmission inputs for Internet access as Title I services, it could not (as some have suggested) still apply Title II-like regulations pursuant to its ancillary jurisdiction in order to meet certain desired policy objectives. The FCC can only exercise ancillary jurisdiction where the object of Commission action is "interstate or foreign communication by wire or radio" under Section 2(a) of the Act (47 U.S.C. § 152(a)) and where the Commission seeks to impose regulation that is "reasonably ancillary" to the effective performance of its responsibilities elsewhere in the Act.[58]

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[57] As the Department of Justice and Federal Bureau of Investigations explained in their joint comments, "[l]aw enforcement agencies are already confronting broadband technology and services in investigations that have serious public-safety and national security implications." *See* DOJ/FBI Comments, CC Dkt. No 02-33 (Apr. 15, 2002) at 6. Moreover, "if the Commission were to establish rules that completely exempt wireline broadband Internet access from the requirements of CALEA . . . then law enforcement will be left with no lawfully-mandated point of access for conducting lawful interception of communications and related information transmitted utilizing this technology." *See id.*

[58] *See U.S. v. Southwestern Cable Co.*, 392 U.S. 157, 178 (1968).

Indeed, the regulation in question must be "imperative if [the FCC] is to perform with appropriate effectiveness certain of its other responsibilities." *See id.* at 173.

While there is little question that the transmission underlying broadband Internet access constitutes "interstate or foreign communication by wire or radio," it is far from clear that imposition of Title II-like requirements on such underlying transmission classified as "telecommunications" could be understood to be "imperative if [the FCC] is to perform its Title II responsibilities." As has been argued, the easy response to such an assertion is that the Commission would not have reclassified the underlying broadband as a non-Title II offering if such regulation were truly "imperative" to advancing the goals set forth therein.[59]

But even if the *policy goals* pursued in imposing Title II-like requirements could be understood as reasonably ancillary to specific Title II statutory requirements, the Commission would still lack the authority to regulate the underlying transmission in this manner. The Commission must advance the policy goals in question by adopting *means* that are consistent with the legislative scheme. For example, in *Midwest Video II*, the Supreme Court reviewed certain common carrier obligations imposed on cable operators by the Commission pursuant to its ancillary jurisdiction. The Court did not question the Commission's conclusion that the imposition of these obligations advanced the Title III policy objectives of increasing outlets for local self-expression and augmenting the public's choice of programs. But it held that the Commission could not advance those goals in a manner that would be prohibited if applied directly to broadcasters subject to the Commission's authority under Title III. As the Court observed, the definition of common carrier in the statute prohibited the Commission from

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[59] *See, e.g.*, Letter from Mark D. Schneider, Counsel for WorldCom, Inc., to Ms. Marlene H. Dortch, CC Dkt. No. 02-33 (Jan. 7, 2003) at 5.

treating a broadcaster subject to Title III as a common carrier. The Court therefore concluded that the imposition of such a requirement was not reasonably ancillary to the Commission's jurisdiction under Title III.[60]

The Commission faces almost exactly the same limitation on the exercise of its ancillary authority in the instant case. As mentioned, the statutory definition of "telecommunications carrier" states that "[a] telecommunications carrier shall be treated as a common carrier under this Act only to the extent that it is engaged in providing telecommunications services." 47 U.S.C. § 153(44). Thus, common carrier obligations, in other words Title II obligations, cannot be imposed on a carrier where its activities fall within a statutory classification other than telecommunications service.

The provision of telecommunications falls into a statutory classification that is distinct from the provision of telecommunications services. The language and legislative history of the Communications Act as well as the Commission's decisions support this conclusion. The statute includes a separate definition of "telecommunications" that is broader than the definition of "telecommunications service;" the former does not include the requirement that the transmission be made available "for a fee directly to the public, or to such classes of users as to be effectively available to the public." *Compare* 47 U.S.C. § 153(43) *with id.* at § 153(45). Furthermore, the requirements of Title II (and, as explained, CALEA) apply to telecommunications services (either directly by referring to telecommunications services or indirectly by referring to telecommunications carriers or common carriers) and do not apply to the provision of telecommunications. The only exception to this rule is Section 254(d), which gives the

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[60] *See FCC v. Midwest Video Corp.*, 440 U.S. 689, 704-06 (1979) ("*Midwest Video*").

Commission the authority to impose universal service contributions on providers of interstate telecommunications.

The legislative history of the 1996 Act indicates that Congress intended that the provision of telecommunications would be classified as private carriage. For example, while the Senate version of the definitions of "telecommunications carrier" and "telecommunications service" were ultimately adopted in the 1996 Act, the House version of the definition of "telecommunications service," like the definition of "telecommunication carrier" ultimately adopted, indicated that telecommunications services were to be treated as common carrier services.[61] In so doing, the House explained that it was "recognizing the distinction between common carrier offerings . . . and private services." *See Joint Explanatory Statement* at 115. Similarly, the reference to providers of interstate telecommunications in Section 254(d) had its origin in Section 253(c) of the Senate bill, which the Senate described as giving the Commission the authority to require "any other telecommunications provider, such as private telecommunications providers, to contribute" to universal service. *See id.* at 129. Since "private" carriers had been deemed exempt from the requirements of Title II prior to the passage of the Act,[62] this legislative history confirms that Congress intended that providers of telecommunications would be treated the same way.[63]

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61 *See* H.R. REP. NO. 104-458, at 115 (1996) ("*Joint Explanatory Statement*").

62 *See NARUC I*, 525 F.2d at 645 (holding that "the Title II common carrier provisions are inapplicable" to private carrier services); *Norlight Request for Declaratory Ruling*, Declaratory Ruling, 2 FCC Rcd 132 (1987) (applying NARUC standard).

63 *See Cable Modem Order*, ¶ 55; *AT&T Submarine Systems, Inc. Application for a License to Land and Operate a Digital Submarine Cable System Between St. Thomas and St. Croix in the U.S. Virgin Islands*, Cable Landing License, 11 FCC Rcd 14885, ¶ 27 (1996) (concluding that there is no basis for concluding that Congress intended to deprive the FCC of its authority to exclude submarine cable operators offering service on a private carriage basis from the requirements of Title II). *Cf. City of New York v. FCC*, 814 F.2d 720, 725 (D.C. Cir. 1987) (holding that "[s]ince Congress legislated against the backdrop of the Commission's preexisting . . . regulation without criticizing that regulation, we infer that Congress

This is of course exactly the way the Commission has treated providers of telecommunications. As the Commission has held, providers of telecommunications "can offer telecommunications on a private-service basis without incurring obligations as a common carrier."[64] Indeed, the extension of Title II universal service contribution obligations in Section 254 to such activities is "unique among the other provisions of the 1996 Act because it permits the Commission to require, if a public interest standard is met, that non-common carriers should contribute to universal service mechanisms along with common carriers." *Report to Congress, supra,* n.19 at ¶ 131.

The Commission also relied on this interpretation in the *Cable Modem Order.* As the it explained there,

> The Commission and the courts have long distinguished between common carriage and private carriage by examining the particular service at issue. As the D.C. Circuit has stated, "the primary *sine qua non* of common carrier status is a quasi public character, which arises out of the undertaking to carry for all people indifferently." In contrast, an entity is a private carrier for a particular service when a carrier "chooses its clients on an individual basis and determines in each particular case 'whether and on what terms to serve' and there is no specific regulatory compulsion to serve all indifferently."[65]

It follows that a "private carrier service [is] not a 'telecommunications service." *Id.*

All of this demonstrates that an incumbent LEC could not be understood to be providing a telecommunications service subject to Title II where all it provides is

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endorsed it, except where the [new legislation] explicitly or implicitly modified its provisions," and holding that no such modification could be found where the terms of the legislation and the legislative history all seemed to comport with Congress' intent to preserve the preexisting regulation).

64 *See Federal-State Joint Board on Universal Service*, Report and Order, 12 FCC Rcd 8776, ¶ 793 (1997).

65 *See Inquiry Concerning High-Speed Access to the Internet Over Cable and Other Facilities; Internet Over Cable Declaratory Ruling; Appropriate Regulatory Treatment for Broadband Access to the Internet Over Cable Facilities,* Declaratory Ruling and Notice of Proposed Rulemaking, 17 FCC Rcd 4798, ¶ 55 (2002) ("*Cable Modem Order*").

telecommunications/private carriage. Section 153(44) explicitly prohibits the Commission from treating a telecommunications carrier as a common carrier when it is not providing a telecommunications service.[66] The logic of *Midwest Video II* is that restrictions such as this on the regulatory forms available to the Commission in its exercise of direct jurisdiction under Title II also limit the Commission's exercise of jurisdiction ancillary to Title II.[67] In fact, the limitation here is arguably even more clearly applicable than was the case in *Midwest Video II*, since Section 153(44) applies by its terms to telecommunications carriers (such as incumbent LECs) whereas the limitation at issue in *Midwest Video II* applied explicitly to broadcasters and only by analogy to cable companies. It is therefore extremely doubtful that the Commission's imposition of Title II requirements on an incumbent LEC service classified as telecommunications/private carriage could pass judicial muster.

V. The *Cable Modem Order* Is Not Inconsistent With This Result.

The Commission's fulfillment of its Title II obligations with regard to incumbent LEC broadband services by maintaining the telecommunications service classification of transmission inputs is not inconsistent with its decision last year to treat cable modem services differently in the *Cable Modem Order*. In the case of cable modem services, the FCC found such retail offerings to be "information services" with an underlying "telecommunications" transmission component under Title I (implicitly, a finding of interstate or international "communications by

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66 As mentioned above, the Commission has recognized that it has the authority (exercised in the context of the *Computer Inquiries*) to require that any entity, including incumbent LECs, provide a service on a common carrier/telecommunications service basis. But what the Commission does not have the authority to do is to allow incumbent LECs to provide a service free from Title II regulation and then apply common carrier requirements to the service pursuant to its ancillary authority.

67 *See also*, *People of the State of California V. FCC*, 905 F.2d 1217, 1240 n.35 (9th Cir. 1990) (holding that the restrictions placed on the Commission's authority over intrastate carrier activities pursuant to Section 152(b) apply equally to the exercise of authority under Title II and to the exercise of authority ancillary to Title II: "The system of dual regulation established by Congress cannot be evaded by the talismanic invocation of the Commission's Title I authority").

wire" under Title I). As explained, the fact that a firm is providing interstate or international communications by wire, does not grant the Commission authority to *exercise* regulatory authority over those communications. Regulation can only be imposed by direct, express reference to the policy goals established in a specific grant of regulatory authority elsewhere in the statute.

The policy goals of Title II have not in the past required that the Commission seek to impose the *Computer Inquiry* framework on the transmission inputs in cable modem service.[68] As explained, the *Computer Inquiries* rules were adopted to prevent the provision of unregulated enhanced services from causing common carrier services to be offered on unjust, unreasonable or unreasonably discriminatory terms and conditions. These concerns were primarily implicated by firms like AT&T and the BOCs, which had market power resulting from their ownership of the core components of the public telecommunications network and their efforts to exploit the provision of unregulated services as a means of evading Title II.

The central policy concern with regard to cable operators has been to ensure that cable service is provided in a manner consistent with regulations that are entirely different from those in Title II (initially established pursuant to the FCC ancillary jurisdiction over broadcasters and later pursuant to Title VI). Among other things, the regulation of cable service does not impose Title II duties to deal as a means of restraining the abuse of market power in the distribution of video services. As explained, the Supreme Court in *Midwest Video II* held that the Commission does not even have the authority to use Title II regulation for this purpose. *See Midwest Video*, 440 U.S. at 704-706.

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[68] There may of course be other reasons why the FCC does not have the authority to impose the *Computer Inquiry* framework on cable modem service.

It has been suggested, however, that the *Computer Inquiry* framework applies to any information service provided over a facility that is used to provide a telecommunications service. Under this view, a cable operator that provided basic voice service over its cable plant would be automatically required to offer the transmission inputs for its cable modem service as a Title II service. But this interpretation is contrary to the logic of the *Computer Inquiries*. Requiring all firms (even those without control over core aspects of the public telecommunications network) that use their facilities in part to provide common carrier service to unbundle the transmission underlying their information services was not necessary to ensure that transmission services were available on just, reasonable and not unreasonably discriminatory terms and conditions. In fact, cable operators themselves provided leased access channels on a common carrier basis at the time some of the *Computer Inquiry* orders were adopted,[69] but it was never suggested that the transmission unbundling rules should apply to cable operators. This is because cable operators did not have market power over core components of the public telecommunications network.

Moreover, the Commission was fully cognizant of enhanced service providers owning their own facilities, and even operating as common carriers for other purposes.[70] For example, notwithstanding the prominence of IBM throughout the course of the *Computer Inquiry* policymaking, it was never suggested that Satellite Business Systems (a specialized common carrier partially owned by IBM) and IBM were subject to the obligation to unbundle the

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69 *See National Association of Regulatory Commissioners v. FCC*, 533 F.2d 601, 609 (D.C. Cir. 1976). As explained, the Supreme Court subsequently held in *Midwest Video II* that the FCC lacked the authority to impose common carrier regulation on cable operators.

70 *See, e.g., AT&T (BPSS 214 Order)* ("IBM has various interests. It is a computer and data terminal equipment manufacturer and an enhanced service provider. It manufacturers communications equipment (itself and through its affiliate, ROLM Corporation), and through its partial ownership of a specialized common carrier, Satellite Business Systems, it has a direct interest in the regulatory treatment of enhanced services generally and in the competitive and policy implications of our action on the waivers.").

transmission underlying information service offerings.[71] Similarly, Telenet was repeatedly described as the prototypical value added network enhanced service provider, yet Telenet was owned at the time by GTE. Further, FCC decisions made it clear that Telenet, among others, was free to offer exclusively enhanced services or to choose to offer basic and enhanced services separately, under the so-called "contamination theory."[72]

Putting aside any other impediments that may exist to the application of Title II to cable modem service, such regulation requires at least that the FCC establish a need to regulate in order to protect and fulfill the agency's Title II obligations. While it may be possible to demonstrate now or at some point in the future that such a nexus exists, no party to the *Cable Modem Order* proceeding appears to have even tried to make this case and, in any event, the FCC did not address this issue. In the case of incumbent LEC broadband transmission inputs, on the other hand, the need for regulatory intervention remains clear because it is necessary to protect the continuation of just and reasonable and not unreasonably discriminatory rates, terms and conditions for both broadband and basic telephone service. Maintaining the existing

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71 IBM subsequently acquired an interest in MCI which it held for much of the relevant history.

72 *See GTE Telenet Application for authority to extend its packet-switched telecommunications services from the Continental United States to the United Kingdom, Western Europe and points beyond*, Memorandum Opinion and Order, 91 FCC 2d 232 (1982). Additionally, in the *Frame Relay* decision, the Common Carrier Bureau assumed that a single unbundling requirement applied to all facilities-based carriers regardless of the implications for the policies underlying Title II. *Independent Data Communications Manufacturers Association, Inc. Petition for Declaratory Ruling that AT&T's InterSpan Frame Relay Service is a Basic Service; and American Telephone and Telegraph Company Petition for Declaratory Ruling that All IXCs be Subject to the Commissions Decision on the IDCMA Petition*, Memorandum Opinion and Order, 10 FCC Rcd 13717 (1995) ("*Frame Relay*"). This assumption cannot be reconciled with the Commission's commitment to the contamination theory. As explained, the record is unambiguous that the latter had been applied to facilities-based carriers without reference to their affiliated common carrier operations. Nor can *Frame Relay* be viewed consistently with *Computer III*. When the FCC chose to eliminate the structural safeguards in *Computer III*, it adopted affirmative CEI/ONA requirements for AT&T and the BOCs. Two of the nine parameters of CEI included unbundling of basic services and resale. *Computer III Phase I Order*, 104 FCC 2d 958, ¶¶ 147-66 (1986). If these requirements already applied to all carriers as a result of the language cited in *Frame Relay*, then two of the CEI parameters would have been superfluous. The Bureau decision in *Frame Relay* should not therefore be dispositive of any Commission analysis of the proper application of the *Computer Inquiry* framework.

framework for incumbent LEC broadband Internet access is therefore not inconsistent with the conclusions in the *Cable Modem Order;* nor does that order compel the FCC to reach a similar conclusion for ILEC broadband transmission inputs.

VI. Conclusion

For the reasons explained herein, the Commission is statutorily bound to retain the telecommunications service classification for the transmission underlying incumbent LEC broadband Internet access. The Title II policy objectives that underlay the *Computer Inquiry* rules continue to compel this approach. Moreover, in no event can the Commission seek to avoid application of the *Computer Inquiry* rules by changing the classification of transmission inputs. Any deregulation of those transmission inputs must be conducted pursuant to the framework set forth in Section 10, which establishes standards that could not possibly be met with regard to incumbent LEC broadband transmission. Lastly, in order to apply Title II to cable modem service, the Commission must at the very least demonstrate that applying *Computer Inquiry*-like rules in this manner is necessary to meet the policy goals of Title II. No party made such a showing and the FCC did not address this issue in the *Cable Modem Order* proceeding. Thus, the FCC is not compelled to reach the same conclusions as to incumbent LEC transmission inputs that it reached for cable modem transmission, and, for the reasons explained herein, it must retain the telecommunications service classification of incumbent LEC broadband transmission services.

APPENDIX

SEC. 10. [47 U.S.C. 160] COMPETITION IN PROVISION OF TELECOMMUNICATIONS SERVICE.

(a) REGULATORY FLEXIBILITY. -- Notwithstanding section 332(c)(1)(A) of this Act, the Commission shall forbear from applying any regulation or any provision of this Act to a telecommunications carrier or telecommunications service, or class of telecommunications carriers or telecommunications services, in any or some of its or their geographic markets, if the Commission determines that --

(1) enforcement of such regulation or provision is not necessary to ensure that the charges, practices, classifications, or regulations by, for, or in connection with that telecommunications carrier or telecommunications service are just and reasonable and are not unjustly or unreasonably discriminatory;

(2) enforcement of such regulation or provision is not necessary for the protection of consumers, and

(3) forbearance from applying such provision or regulation is consistent with the public interest.

(b) COMPETITIVE EFFECT TO BE WEIGHED. -- In making the determination under subsection (a)(3), the Commission shall consider whether forbearance from enforcing the provision or regulation will promote competitive market conditions, including the extent to which such forbearance will enhance competition among providers of telecommunications services. If the Commission determines that such forbearance will promote competition among providers of telecommunications services, that determination may be the basis for a Commission finding that forbearance is in the public interest.

(c) PETITION FOR FORBEARANCE. -- Any telecommunications carrier, or class of telecommunications carriers, may submit a petition to the Commission requesting that the Commission exercise the authority granted under this section with respect to that carrier or those carriers, or any services offered by that carrier or carriers. Any such petition shall be deemed granted if the Commission does not deny the petition for failure to meet the requirements for forbearance under subsection (a) within one year after the Commission receives it, unless the one-year period is extended by the Commission. The Commission may extend the initial one-year period by an additional 90 days if the Commission finds that an extension is necessary to meet the requirements of subsection (a). The Commission may grant or deny a petition in whole or in part and shall explain its decision in writing.

(d) LIMITATION. -- Except as provided in section 251(f), the Commission may not forbear from applying the requirements of section 251(c) or 271 under subsection (a) of this section until it determines that those requirements have been fully implemented.

(e) STATE ENFORCEMENT AFTER COMMISSION FORBEARANCE. -- A State commission may not continue to apply or enforce any provision of this Act that the Commission has determined to forbear from applying under subsection (a).

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