Tariffing Internet Termination: Pricing Implications of Classifying Broadband as a Title II Telecommunications Service

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I. INTRODUCTION

Since the early days of the Internet, the Federal Communications Commission (the "Commission") has taken a largely "hands off" regulatory approach to broadband Internet services—a light touch widely-held to be a key contributor to the rapid innovation, diffusion and adoption of Internet services in the United States.[1] Facilitating this deregulatory approach was the agency's classification of broadband Internet access as an "information service" under Title I of the Communications Act.[2] Despite the success of this approach, and in response to the agency's struggles to construct legally sustainable "Open Internet" rules,[3] the Commission is coming under intense political pressure to reverse course and classify broadband Internet connectivity as a common carrier telecommunications service under Title II.[4] Doing so, it is argued, is the only way to provide the agency with

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1. *See, e.g.*, J. Oxman, *The FCC and the Unregulation of the Internet* (FCC, OSP Working Paper No. 31, 1999), *available at* http://www.fcc.gov/working-papers/fcc-and-unregulation-internet; K. High, *Digital Pioneers Remember Past, Forecast Future of the Internet*, POLITIC365 (December 6, 2013, 3:09 PM), http://politic365.com/2013/12/06/digital-pioneers-remember-past-forecast-future-of-the-internet.

2. *See, e.g.*, Nat'l Cable & Telecomms. Ass'n v. Brand X Internet Servs., 545 U.S. 967 (2005) (cable modem); Appropriate Framework for Broadband Access to the Internet over Wireline Facilities, *Report and Order*, FCC 05-150, 20 FCC Rcd. 14853, 14862 (2005), *aff'd* Time Warner Telecom, Inc. v. FCC, 507 F.3d 205 (3d Cir. 2007) (wireline broadband); Appropriate Reg. Treatment for Broadband Access to the Internet over Wireless Networks, *Declaratory Ruling*, FCC 07-30, 22 FCC Rcd. 5901 (2007) (wireless broadband); United Power Line Council's Petition for Declaratory Ruling Regarding the Classification of Broadband over Power Line Internet Access Serv. as an Information Serv., *Memorandum Opinion and Order*, FCC 06-165, 21 FCC Rcd. 13281, 13281 (2006) (broadband over powerline).

3. Protecting and Promoting the Open Internet, *Notice of Proposed Rulemaking*, FCC 14-61, 29 FCC Rcd. 5561 (2014) [hereinafter *2014 Open Internet NPRM*], *available at* https://apps.fcc.gov/edocs_public/attachmatch/FCC-14-61A1.pdf.

4. *See, e.g.*, Lawrence J. Spiwak, *The "Clicktivist" In Chief,* THE HILL (November 12, 2014) (http://thehill.com/blogs/pundits-blog/technology/223744-the-clicktivist-in-chief); Brendan Sasso, *In Net-Neutrality Push, Democrats Aim to Make the Internet a Utility,* NAT'L J. (July 14, 2014), http://www.nationaljournal.com/tech/in-net-neutrality-push-democrats-aim-to-make-the-internet-a-utility-20140714?ref=the_edge; Kate Tummarello, *Senate Dems: Regulate Internet Like Telephones*, THE HILL (July 15, 2014, 11:30 AM), http://thehill.com/policy/technology/212270-senate-dems-want-to-regulate-the-internet-like-phones. The full text of the letter is available on Senator Markey's

sufficient legal authority to prevent Broadband Service Providers ("BSPs") from engaging in anticompetitive conduct.[5]

This reclassification debate begs the question: How does classifying broadband as a common carrier telecommunications service help protect the "Open Internet"? According to proponents of reclassification, the answer lies in the direct application of Sections 201 and 202 of the Communications Act.[6] As stated by the advocacy group Public Knowledge, "Sections 201 and 202 provide strong statutory grounding for creating strong rules to protect an open internet."[7] Section 201 requires rates to be "just and reasonable"[8] while Section 202 prohibits "unreasonable discrimination."[9] These two sections, it is argued, can be used to prevent Broadband Service Providers from establishing slow and fast lanes for the delivery of edge-provider traffic to consumers, since such differential treatment of edge providers could be labeled by the Commission as

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webpage at: http://www.markey.senate.gov/news/press-releases/to-protect-net-neutrality-markey-leads-senate-dems-in-call-to-reclassify-broadband-as-a-utility.

5. This argument is inaccurate. *See* Lawrence J. Spiwak, *What Are the Bounds of the FCC's Authority over Broadband Service Providers?—A Review of the Recent Case Law*, 18 J. INTERNET L. 1 (Jan. 2015).

6. *See, e.g.*, Comments of Pub. Knowledge & Common Cause at 12, Open Internet Remand, FCC GN Docket 14-28 (rel. March 21, 2014) [hereinafter *Public Knowledge Comments*], *available at* http://apps.fcc.gov/ecfs/document/view?id=7521094713; Comments of Mozilla at 6, 13, Protecting and Promoting the Open Internet, FCC GN Docket 14-28 (rel. July 15, 2014) [hereinafter *Mozilla Comments*], *available at* http://apps.fcc.gov/ecfs/document/view?id=7521479935; Comments of AARP at 41-42, Protecting and Promoting the Open Internet, FCC GN Docket 14-28 (rel. July 15, 2014), *available at* http://apps.fcc.gov/ecfs/document/view?id=7521705861.

7. Public Knowledge Comments, *supra* note 6, at 12.

8. Section 201 of the Communications Act, 47 U.S.C. § 201(b), provides in relevant part that "All charges, practices, classifications, and regulations for and in connection with such communication service, shall be just and reasonable, and any such charge, practice, classification, or regulation that is unjust or unreasonable is declared to be unlawful . . . ."

9. Section 202 of the Communications Act, 47 U.S.C. § 202(a), states:

> It shall be unlawful for any common carrier to make any unjust or unreasonable discrimination in charges, practices, classifications, regulations, facilities, or services for or in connection with like communication service, directly or indirectly, by any means or device, or to make or give any undue or unreasonable preference or advantage to any particular person, class of persons, or locality, or to subject any particular person, class of persons, or locality to any undue or unreasonable prejudice or disadvantage

"unreasonable discrimination."[10] Network Neutrality advocate and law professor Marvin Ammori, pointing to Section 201 and 202, claims "under Title II, the FCC can eliminate certain classes of fees and discrimination, including banning paid prioritization (a.k.a. fast lanes) on the Internet altogether."[11]

Thus far, the advocates for reclassification have put forth mostly superficial arguments, suited more for political markets than for policymakers (and consumers) trying to grasp the full implications of such a significant regulatory change.[12] Almost no attention has been directed at the fine details of how reclassification would be implemented. To wit, what service is to be reclassified and regulated? Who are the buyers and sellers impacted by reclassification? What enforcement mechanisms are available? In this ARTICLE, we address these specific issues. Our legal and economic review forces us to conclude that reclassification is likely to cause a radical change in the economic fabric of the Internet ecosystem.

Relying on the plain terms of the Commission's governing statute, current case law, and the Commission's own precedent, we show that reclassification turns edge providers into "customers" of Broadband Service Providers. This new "carrier-to-customer" relationship (as opposed to a "carrier-to-carrier" relationship) would then require all BSPs (i.e., telephone, cable, and wireless broadband providers) to create, and then tariff, a *termination service* for Internet content under Section 203 of the Communications Act. Critically, this termination service would be separate

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10. Public Knowledge Comments, *supra* note 6, at 12. ("Violating any nondiscrimination rule will necessarily involve violating Sections 201 and 202 by engaging in practices that unjustly or unreasonably give preference to or disadvantage a particular class of persons: namely, the users of particular lawful applications, services, or content.")

11. Marvin Ammori, *Title II and Paid Prioritization*, AMMORI.ORG (May 12, 2014), http://ammori.org/2014/05/12/title-ii-and-paid-prioritization. Despite such cursory claims, Sections 201 and 202 do not prohibit the establishment of slow and fast lanes; decades of rate regulation plainly show that establishing slow and fast lanes is entirely consistent with Sections 201 and 202 of the Act, if not, as some argue, mandated by them. Differential quality and pricing under Title II is commonplace, so it will be very difficult for the Commission to prohibit paid prioritization under Title II regulation, despite the *ad hoc* arguments to the contrary.

12. Indeed, press reports indicate that some 60 percent of initial comments to the Commission's *2014 Open Internet NPRM* came in the form of letters pre-written by advocacy campaigns. According to the Washington Post, this "suggests a heavy role for 'clicktivists,' or members of the public who weighed in by doing nothing more than clicking a button in an e-mail or on a Web site." *See* Brian Fung, *Sunlight: 99 Percent of Net Neutrality Comments Wanted Stronger FCC Rules*, WASH. POST, Sept. 2, 2014, http://www.washingtonpost.com/blogs/the-switch/wp/2014/09/02/sunlight-99-percent-of-net-neutrality-comments-wanted-stronger-fcc-rules; *see also Clictivist in Chief, supra* note 4.

and apart from any carrier-to-carrier agreements to deliver traffic.[13] Because a tariffed rate cannot be set arbitrarily, and since a service cannot be generally tariffed at a price of zero, reclassification would require all edge providers (not their carriers)—as customers of the BSP—to make direct payments to the BSPs for termination services. That is, *all content providers*, whether Netflix or a church website (or its host company), would be on the hook to pay every broadband service provider a positive termination fee.[14] Most importantly, the agency would likely be prohibited from using its authority under Section 10 of the Communications Act to forbear from such tariffing requirements because the Commission has labeled all BSPs as "terminating monopolists." In the presence of a terminating monopoly in the relevant market (i.e., each BSP is "dominant" for terminating access to their customers), competition—a key prerequisite for invoking section 10—cannot be used as a basis for forbearance for "terminating services." Accordingly, the agency has boxed itself in for mandatory tariffing under Title II. In light of the above, we can find no

13. The discrimination feared by net neutrality advocates regards specific forms of content, not specific carriers. Carriers deliver all types of content. Thus, the issue is not about degrading or enhancing the delivery of the entirely of a carrier's traffic, but the picking-and-choosing of some of the content of a carrier's (or multiple carriers') total traffic. As discussed *infra*, the carrier-to-carrier relationships are very different than those contemplated in the network neutrality debate.

14. Today, much carrier-to-carrier termination, also subject to Section 201 and 202, is arguably priced at "zero" under the Commission's Bill-and-Keep regulatory approach. Carrier-to-carrier relationships, governed by Section 252 of the Communications Act, are not "customer" relationships, and edge providers are not, today, considered carriers (the companies carrying their traffic are carriers). *See* Connect America Fund, *Report and Order and Further Notice of Proposed Rulemaking*, FCC 11-161, 26 FCC Rcd. 17663 (2011) [hereinafter *USF/ICC Transformation Order*]. The difference between carriers and customers is substantial. As observed by the Tenth Circuit Court of Appeals in In re FCC 11-161, 753 F.3d 1015 (10th Cir. 2014), when ruling on the FCC's *USF/ICC Transformation Order*, carrier-to-carrier relationships involve the "recovery of costs through the offsetting of reciprocal obligations," and that to the extent costs are not recovered, "[s]tates are free to set end-user rates, and the Order does not prevent states from raising end-user rates to allow a fair recovery of termination costs" and "the FCC reforms include funds for carriers that would otherwise lose revenues." *Id.* at 1128-30; *see also* Ace Tel. Ass'n v. Koppendrayer, 432 F.3d 876, 880 (8th Cir. 2005) (stating that a reciprocal compensation rate of zero did not violate the "reasonably approximation of the additional costs" requirement). If the carrier-to-carrier Bill-and-Keep type regime is created for edge provider termination service to BSPs, then edge providers must become telecommunications carriers, a point at which they are likewise subject to Title II regulation. The implications of classifying edge providers as Title II common carriers is beyond the scope of this ARTICLE, but certainly an interesting issue worthy of investigation.

clear, legally supported path to a "Title II Lite" that avoids a tariffed termination service.[15]

To explore this complex issue in detail, this ARTICLE is organized as follows: In Section II we delineate the relevant market and show how reclassification turns edge providers into customers of BSPs, thereby creating a formal, regulated termination market. In Section III, we demonstrate that BSPs must set tariffs for this termination service, and the established rates would most likely have a positive price. In Section IV, we show that the Commission's own precedent likely prohibits forbearance of the tariffing requirements of Section 203 of the Communications Act. Conclusions and policy recommendations are provided in the final section.

II. RECLASSIFICATION AND THE CREATION OF A TERMINATION MARKET

If the FCC is to impose regulations to protect the "Open Internet," then it is essential to define exactly what transaction will be regulated, along with identifying the buyers and sellers involved in this transaction. That is, the relevant market must be established. Using the Commission's *2010 Open Internet Order*,[16] the D.C. Circuit's remand of the agency's Network Neutrality efforts in *Verizon v. FCC*,[17] and the agency's *2014 Open Internet NPRM*,[18] it is possible to sharply delineate the relevant transaction.

We first turn to the Commission's *2014 Open Internet NPRM* for a clear depiction of the relevant market. There, the agency defines the "Open Internet" as a broadband ecosystem that "allows innovators and consumers at the edges of the network to create and determine the success or failure of content, applications, services and devices, without requiring permission from the broadband provider to reach end users."[19] In this statement, "permission" is the key word. According to both the Commission and the D.C. Circuit in *Verizon*, the BSP's ability to grant or deny "permission" to

15. It should be noted that former Commission Chairman Julius Genachowski attempted to float such an idea for a "Title II Lite" but ultimately rejected it. *See* George S. Ford, Lawrence J. Spiwak, & Michael L. Stern, *The Broadband Credibility Gap*, 19 COMMLAW CONSPECTUS 75 (2010), *available at* http://www.phoenix-center.org/papers/CommlawConspectusBroadbandCredibilityGap.pdf [hereinafter *Broadband Credibility Gap*].

16. Preserving the Open Internet, *Report and Order*, FCC 10-201, 25 FCC Rcd. 17905 (2010) [hereinafter *2010 Open Internet Order*], *available at* https://apps.fcc.gov/edocs_public/attachmatch/FCC-10-201A1.pdf.

17. Verizon v. FCC, 740 F.3d 623 (D.C. Cir. 2014).

18. *2014 Open Internet NPRM*, *supra* note 3.

19. *Id.* at para. 1 (internal quotation marks omitted).

particular edge providers arises from the belief that BSPs are "terminating monopolies" (or "gatekeepers") and thus may exert control over the flow of Internet traffic over the last mile connection.[20] A BSP's interference with the flow of content from the edge to the customer is argued to disrupt the "virtuous circle of innovation" in the broadband ecosystem.[21]

The *2014 Open Internet NPRM* lays out three concerns arising from the "terminating monopolist's" control over traffic flow over the last mile: (a) broadband providers may have economic incentives to block or disadvantage a particular *edge provider* or class of *edge providers*; (b) broadband providers may have incentives to increase revenues by charging *edge providers* for access or prioritized access to broadband providers' end users; and (c) broadband providers, if charging positive prices for prioritized service, would have an incentive to degrade or decline the quality of service they provide to non-prioritized traffic.[22] The Commission and proponents of reclassification point to offerings such as Verizon's "expressed interest in pursuing commercial agreements with edge providers" and AT&T's "new sponsored data service, in which an edge provider enters an agreement with AT&T to sponsor and pay for data charges resulting from eligible uses of the sponsor's content by an AT&T mobile subscriber" as examples.[23] From these statements, it is clear that *the relevant transaction which the FCC would have to regulate under Title II is the one between BSPs and edge providers.*[24] As observed by the

20. *2010 Open Internet Order, supra* note 16, at para. 24; *Verizon,* 740 F.3d at 646; *2014 Open Internet NPRM, supra* note 3, at para. 42. Indeed, the D.C. Circuit went out of its way to find that this "terminating monopoly" was reinforced by the fact that not only do consumers have "limited" competitive options because "only one or two wireline or fixed wireless firms" provide service in most markets, but also that consumers face high switching costs for such services, including "early termination fees; the inconvenience of ordering, installation, and set-up, and associated deposits or fees; possible difficulty returning the earlier broadband provider's equipment and the cost of replacing incompatible customer-owned equipment; the risk of temporarily losing service; the risk of problems learning how to use the new service; and the possible loss of a provider-specific email address or website." *Verizon* 740 F.3d at 646-47.

21. *Verizon,* 740 F.3d at 649; *2010 Open Internet Order, supra* note 16, at para. 14.

22. *2014 Open Internet NPRM, supra* note 3, at para. 6.

23. *Id.* at para. 37.

24. Mozilla, in its filing before the Commission, makes the same argument, calling for the creation of "a new type of service" that is "the offering of delivery of traffic, upstream and downstream, to a remote edge provider . . . . [This] remote delivery service connects each of the Internet's edge providers to all of the local network's subscribers." Mozilla Comments, *supra* note 6, at 9-10. Mozilla uses the analogy of an apartment building doorman:

Commission, the relevant transaction for "Open Internet" regulations is the "second side of the market—between broadband providers and edge providers or other third parties."[25] The service provided in this "second side of the market" is *termination*, a fact made clear by the use of the term "terminating monopolies." Thus, according to the Commission's logic, to protect the "Open Internet," any rules must target the transactions between edge providers on the demand side and BSPs on the supply side of the market in which a termination service is traded.

Historically, edge providers have not been considered "customers" of the BSPs.[26] Upon reclassification, however, edge providers would formally and legally become *customers* of BSPs.[27] In *Verizon v. FCC*, the creation of this new termination market is made plain:

> It is true, generally speaking, that the "customers" of broadband providers are end users. But that hardly means that broadband providers could not also be carriers with respect to edge providers . . . . [b]ecause broadband providers furnish a

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> It works a little bit like a doorman in a high-end condominium or apartment building. The doorman offers a service to the building's residents, in holding their mail (whether it has arrived or is waiting to be sent out). But the doorman is also, at the same time, effectively offering a service to Amazon, Best Buy, Netflix (for its DVD shipments), and any other company that the resident purchased a good from. In this metaphor, the doorman (who functions as the gatekeeper for millions of individual residents) is considering asking some shippers to pay more to make sure the subscriber gets their goods right away, while packages from non-preferred shippers might be left in the mailroom for a day or two. Mozilla is asking for the relationship between the doorman and the shipper to be codified, separate from the relationship between the doorman and the resident, even though the act of holding onto the packages is the same for both relationships. *Id.* at 10.

25. *2014 Open Internet NPRM*, *supra* note 3, at para. 37.

26. Of course, a termination service is provided, but to date transactions directly between BSPs and edge providers have not been commonplace, but not entirely absent either. *See, e.g.*, Eliot Van Buskirk, *ESPN to ISPs: Pay for Your Customers to Play Video*, WIRED (Feb. 5, 2009, 5:18 PM), http://www.wired.com/2009/02/espn-stands-fir; S. Nassauer, *ESPN Charges Net Providers for Right to Offer Broadband Web Site*, WALL ST. J. (Aug. 1, 2006), http://online.wsj.com/article/SB115439535367922979.html.

27. Under 47 U.S.C. § 201(a), every common carrier engaged in interstate or foreign communication by wire or radio has a "duty . . . to furnish such communication service upon reasonable request therefor." It may be that some edge providers could be classified as carriers, either on their own motion or as a result of Commission action. As carriers, the exchange of traffic would be governed by rules related to carrier-to-carrier traffic exchange.

> service to edge providers, thus undoubtedly functioning as edge providers' "carriers" . . . regardless of whether edge providers are broadband providers' principal customers. This is true whatever the nature of the preexisting commercial relationship between broadband providers and edge providers . . . . No one disputes that a broadband provider's transmission of edge-provider traffic to its end-user subscribers represents a valuable service: an edge provider like Amazon wants and needs a broadband provider like Comcast to permit its subscribers to use Amazon.com.[28]

By reclassifying broadband as a telecommunications service, this termination service becomes a common carrier telecommunications service, thereby formalizing this "customer" relationship between edge providers (e.g., Amazon) and BSPs. Recalling that the D.C. Circuit in *Verizon* remanded the agency's *2010 Open Internet Order* because the agency effectively turned BSPs into common carriers, consider the court's statement:

> [G]iven the Open Internet Order's anti-blocking and anti-discrimination requirements, if Amazon were now to make a request for service, Comcast must comply. That is, Comcast must now "furnish . . . communication service upon reasonable request therefor."[29]

This "furnish[ed] communications service" is termination. Thus, with reclassification, the Commission creates a *termination* market—*an entirely new service involving edge providers and BSPs*.[30] This termination market

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28. Verizon v. FCC, 740 F.3d 623, 653 (D.C. Cir. 2014).
29. *Id.* at 653-54 (emphasis in original).
30. Significantly, in the Commission's *2014 Open Internet NPRM,* the agency highlights its own concerns about the possibility that edge providers will formally become "customers" of BSPs. *See 2014 Open Internet NPRM*, *supra* note 3, at para. 151.

> Separate from the reclassification of "broadband Internet access service," we seek comment on how the Commission should consider broadband providers' service to edge providers and whether that service (or some portion of it) is subject to Title II regulation. As mentioned above, in *Verizon*, the D.C. Circuit stated that "broadband providers furnish a service to edge providers, thus undoubtedly functioning as edge providers' 'carriers.'" We understand such service to include the flow of Internet traffic on the broadband providers' own network, and not how it gets to the broadband providers' networks . . . . We seek comment on whether and, if so how, the Commission should separately identify and classify a

is separate and apart from the carrier-to-carrier delivery of Internet traffic. We turn now to how creating this new "termination market" might be regulated to protect the "Open Internet."

III. A NEW TERMINATION MARKET

As we have detailed above, the Commission and the courts conclude that Network Neutrality addresses the terminating market in which edge providers are the buyers and BSPs are the sellers. It follows that *it is this terminating market, formalized by reclassification, which must be regulated to protect the Open Internet*. Legal precedent suggests that in order for the Commission to effectively regulate this terminating market under the auspices of Sections 201 and 202, BSPs would be required to file (positive-price) tariffs under Section 203 for this new termination service. Such a regulated transaction does not occur today, but the D.C. Circuit in *Verizon* recognized that this absence places no limitation on the consequences of reclassification. Under this plausible scenario, therefore, edge providers would be required to pay a tariffed rate to BSPs for the termination of their traffic to end users. After all, a "telecommunications service," which is what broadband becomes upon reclassification, is defined as "the offering of telecommunications *for a fee*."[31]

While a thorough discussion of the tariffing process is beyond the scope of this ARTICLE, a brief background may prove fruitful in what we expect to be a healthy debate over the potential rate regulation of the "termination market." First, we have Section 201, which requires, *inter alia*, that a common carrier's rates must be "just and reasonable."[32] We also have Section 202, which prohibits a carrier from engaging in "unreasonable

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broadband service that is furnished by broadband providers' to edge providers in order to protect and promote Internet openness. *Id.*

31. 47 U.S.C. § 153(53) (2012). Mozilla claims that the "fee" need not be monetary compensation, but there is no precedent for that in end-user markets (though the Commission views the exchange of traffic in carrier-to-carrier relationships as a form of compensation, thus justifying a bill-and-keep regime). Interconnection is not treated as a telecommunications service. Mozilla also contends that the termination fee may be set to zero in light of a positive price for broadband access paid by the end user. Mozilla Comments, *supra* note 6, at 11-12. However, termination and end-user services are entirely different markets and, we suspect, will be classified differently for regulatory purposes (*i.e.*, termination is a telecommunications service, end-user broadband is an information service). If end-user services are not regulated, ensuring they are fully compensatory, then using positive end-user prices as a basis for a zero termination charge is legally suspect, and some might argue such a scheme is a subsidy from consumers to edge providers.

32. 47 U.S.C. § 201(b) (2012).

discrimination" or providing for "undue" preferences.[33] Section 201 and 202 are, in turn, enforced by Section 203, which requires a common carrier to file a tariff with the Commission.[34] If, after an opportunity for a hearing, the Commission finds that the filed rate is not "just and reasonable" or is "unreasonably discriminatory," then the Commission can adjust the rate under Section 205.[35] Moreover, as a backstop, there is Section 208, which allows interested parties to file a complaint with the Commission.[36]

Rate setting is not as simple as it seems.[37] Regarding the first prong of the test ("just and reasonable"), it is well established that a rate must fall into what is referred to as the "zone of reasonableness"—*i.e.*, it cannot be "confiscatory" (*i.e.*, "below cost") on the bottom end and "excessive" on the high end. As a result, while rates cannot allow a monopoly return, a rate generally must have a "positive" price (*i.e.*, it cannot be set at "zero"). Given the multiple methodologies used to set rates, (*e.g.*, price cap, rate of return, LRIC, TELRIC, etc.) and the formidable complexity of measuring cost and demand, both courts and the Commission have consistently recognized that ratemaking is "far from an exact science."[38]

Given the lack of historical termination fees for Internet traffic, how termination rates will be formulated is a complex matter. Evaluating a filed rate, especially if it is rejected, will require some sort of cost study for termination services. Unquestionably, the cost is not zero—there are no

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33. 47 U.S.C. § 202(a) (2012). Section 202 of the Communications Act states:

> It shall be unlawful for any common carrier to make any unjust or unreasonable discrimination in charges, practices, classifications, regulations, facilities, or services for or in connection with like communication service, directly or indirectly, by any means or device, or to make or give any undue or unreasonable preference or advantage to any particular person, class of persons, or locality, or to subject any particular person, class of persons, or locality to any undue or unreasonable prejudice or disadvantage. *Id.*

34. 47 U.S.C. § 203 (2012).
35. 47 U.S.C. § 205 (2012).
36. 47 U.S.C. § 208 (2012).
37. Indeed, the phrase "just and reasonable" is not "a mere vessel into which meaning must be poured." *See* Farmers Union Cent. Exch. v. FERC, 734 F.2d 1486, 1504 (D.C. Cir.), *cert denied sub nom.*, Williams Pipe Line Co. v. Farmers Union Cent. Exch., 469 U.S. 1034 (1984).
38. *See, e.g.*, Fed. Power Comm'n. v. Conway Corp., 426 U.S. 271, 278 (1976*);* WorldCom v. FCC, 238 F.3d 449, 457 (D.C. Cir. 2001); Sw. Bell Telephone Co. v. FCC, 168 F.3d 1344, 1352 (D.C. Cir. 1999); United States v. FCC, 707 F.2d 610, 618 (D.C. Cir. 1983); *see also* Access Charge Reform, *Fifth Report and Order and Further Notice of Proposed Rulemaking*, FCC 99-206, 14 FCC Rcd. 14221, at paras. 96, 144 (1999) (the Commission justified its deregulatory triggers by noting that "regulation is not an exact science"); George S. Ford & Lawrence J. Spiwak, *The Need for Better Analysis of High Capacity Services*, 28 JOHN MARSHALL J. COMPUTER & INFORMATION L. 343 (2011).

free lunches. In fact, it could be argued that most of the costs of the broadband network are related to termination, since the bulk of traffic is downstream rather than upstream (a ratio of about 6:1).[39] Under a fully-distributed cost formula, after reclassification, it is feasible that much of the BSPs revenue could be collected on the termination side of the two-sided market.[40] As such, the tariffed termination fee to be paid by edge providers will not only be positive, but, in the end, it may turn out that the revenues from termination make up the lion's share of BSP revenue from the sale of broadband service.[41]

Regarding the second prong of the standard (that any rate must also not be "unreasonably" discriminatory), note that the operative word here is "unreasonable"—*i.e.*, *reasonable* discrimination in service offerings is perfectly acceptable. Thus, according to well-established case law, any charge that a carrier has unreasonably discriminated must satisfy a three-step inquiry (in sequence): (1) whether the services offered are "like"; (2) if they are "like," whether there is a price difference among the offered services; and (3) if there is a price difference, whether it is reasonable.[42] If the services are not "like," or not "functionally equivalent" in the legal parlance, then discrimination is not an issue and the investigation ends. There is no valid discrimination claim for *different* prices or price-cost ratios for *different* goods.

Notably, a determination of whether services are "like" is based upon neither cost differences nor competitive necessity. Cost differentials are excluded from the likeness determination and introduced only to determine "whether the discrimination is unreasonable or unjust." Likeness is based solely on functional equivalence.[43] If the services are determined to be "like" or "functionally equivalent," then the carrier offering them has the

39. SANDVINE, GLOBAL INTERNET PHENOMENA REPORT 1H 2014 at 5 (2014, *available at* https://www.sandvine.com/downloads/general/global-internet-phenomena/2014/1h-2014-global-internet-phenomena-report.pdf.

40. STEPHEN J. BROWN & DAVID S. SIBLEY, THE THEORY OF PUBLIC UTILITY PRICING 44-49 (1986). Rate setting also has a strong dose of politics. *See, e.g.*, T. Randolph. Beard & George S. Ford, *Splitting the Baby: An Empirical Test of Rules of Thumb in Regulatory Price Setting*, 58 KYKLOS 331-51 (2005); T. Randolph. Beard & Henry Thompson, *Efficient Versus "Popular" Tariffs for Regulated Monopolies*, 69 J. BUS. 75-87 (1996).

41. Depending on how one views the issue, this would be a positive result, because under the theory of two-sided markets, such a change in financing of last-mile networks could lead to sizeable reductions in end-user rates and thus expand adoption. Similarly, tariffing terminating access would now force edge providers to pay into universal service, thus raising the possibility that universal service contributions charged to end consumers would also be reduced.

42. *See, e.g.*, MCI Telecomms. Corp. v. FCC, 917 F.2d 30, 39 (D.C. Cir. 1990) and citations therein.

43. *Id.*

burden of justifying any price disparity as reasonable, such as a difference in cost.[44] If a price difference is not justified, then the price difference is deemed unlawful. One usual measure to determine reasonableness is an inquiry as to whether the different rates are offered to "similarly situated" customers.[45] That is, are the customers roughly the same size and do they exchange similar levels of traffic, or, for example, is one customer a wholesale customer while the other only buys at retail? In the standard course of regulating telecommunications rates, such distinctions permit different rates.[46] Critically, a prioritized termination service is not the functional equivalent of the typical termination service, so there is no claim of unreasonable discrimination under Section 202 across the two services. To the extent network neutrality is about slow and fast lanes, reclassification offers no power to prohibit their creation. In fact, it seems more likely that reclassification facilitates the creation of prioritized termination.

In sum, under standard, utilities-style rate-setting rules, the tariffed rates for this "new" termination service "created" by reclassification must be positive to avoid a confiscatory rate, could be quite large under common rate setting methodologies, and may very well differ across edge provider types. These charges will apply to edge providers and not their carriers, and can reasonably be expected to apply to all edge providers—from Netflix, to Amazon, to a political candidate's website. Plainly, reclassification is a radical change on the Internet ecosystem, and, surprisingly, the agency's authority to impede fast and slow lanes under Title II is exceedingly weak.

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44. *Id.*

45. *See, e.g.*, Competition in the Interstate Interexchange Marketplace, *Notice of Proposed Rulemaking*, FCC 90-90, 5 FCC Rcd. 2627, at paras. 131-39 (1990) (citing Associated Gas Distribs. v. FERC, 824 F. 2d 981, 1007-1013 (D.C. Cir. 1987); *but cf.* Orloff v. FCC, 352 F.3d 415, 418 (D.C. Cir. 2003), *cert. denied*, 542 U.S. 937 (2004) (allowing a mobile CMRS carrier to charge different promotional rates to similarly situated retail customers under competitive market conditions).

46. For a deeper exploration of this topic, *see, e.g.*, George S. Ford & Lawrence J. Spiwak, *Non-Discrimination or Just Non-Sense: A Law and Economics Review of the FCC's New Net Neutrality Principle* (Phx. Ctr. Policy Perspectives No. 10-03 (2010)), *available at* http://www.phoenix-center.org/perspectives/Perspective10-03Final.pdf.

IV. FORBEARANCE AND THE TERMINATING MONOPOLY PROBLEM

By any standard, Title II is burdensome and many parts of it are unnecessary for modern communications markets.[47] As a result, some of the more conscientious parties arguing for reclassification concede that the Commission should use its authority contained in Section 10 of the Communications Act to forbear from portions of Title II.[48] As we explain here, however, given both the D.C. Circuit's holding in *Verizon* and the Commission's prior holdings, forbearance from the tariffing requirements of Section 203 will prove difficult for the agency. As such, there appears to be significant legal challenges to the formation of a "Title II Lite" that excludes creating and tariffing a termination service.[49]

It is now recognized that Network Neutrality is rate regulation (albeit "zero" price regulation), and the reclassification proponents' reliance on Sections 201 and 202 make that fact clear enough.[50] Rate regulation of consumer rates under Section 201 and 202 is effectuated through the filing of tariffs under Section 203.[51] Oddly, we are unaware of any proposal that

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47. *See* Fed.-State Joint Bd. on Universal Servs., *Report to Congress*, FCC 98-67, 13 FCC Rcd. 11830, at para. 82 (1998), *available at* http://www.fcc.gov/Bureaus/ Common_Carrier/Reports/fcc98067.pdf [hereinafter *Federal-State Joint Board*] ("classifying Internet access services as telecommunications services could have significant consequences for the global development of the Internet. We recognize the unique qualities of the Internet, and do not presume that legacy regulatory frameworks are appropriately applied to it").

48. *See, e.g.*, Public Knowledge Comments, *supra* note 6, at 12 ("When combined with the Commission's Section 10 forbearance ability, Title II provides the clear statutory authority to implement rules critical to protecting an open internet while avoiding importing unnecessary legacy regulations of the past.").

49. For a detailed analysis of the FCC's forbearance authority, *see* George S. Ford and Lawrence J. Spiwak, *Section 10 Forbearance: Asking The Right Questions To Get The Right Answers*, 23 COMMLAW CONSPECTUS 126 (2014) *available at* http://scholarship.law.edu/commlaw/vol23/iss1/5.

50. Indeed, one of the reasons the D.C. Circuit struck down the Commission's last set of Open Internet rules is because the Commission forced BSPs to charge a "zero" price to all comers for broadband Internet access. *See* Verizon v. FCC, 740 F.3d 623 (D.C. Cir. 2014). For a full discussion, *see* Spiwak, *What Are the Bounds of the FCC's Authority, supra* note 5.

51. Section 203 requires that:

> Every common carrier, except connecting carriers, shall, within such reasonable time as the Commission shall designate, file with the Commission and print and keep open for public inspection schedules showing all charges for itself and its connecting carriers for interstate and foreign wire or radio communication between the different points on its own system, and between points on its own system and

specifically recognizes that Section 203 is an essential element of any "Title II Lite," though at least one party alludes to the risk of forbearing from tariff filings.[52] Presumably, reclassification advocates take for granted that the Commission would forbear from Section 203.[53] Yet, there has been no serious analysis on the question of whether forbearance is a legitimate option for the enforcement of an "Open Internet," particularly in regard to tariff filings.[54] The Commission's prior holdings and the D.C. Circuit's ruling in *Verizon* would seem to preclude forbearance from Section 203 for the new termination service.

Under Section 10 of the Communications Act, the Commission may forbear from sections of the Act if, after doing so, the rates, terms and conditions for telecommunications services remain just, reasonable, and nondiscriminatory. Forbearance must also be in the public interest.[55] In all significant cases of forbearance from Section 203, the Commission has

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> points on the system of its connecting carriers or points on the system of any other carrier subject to this chapter when a through route has been established, whether such charges are joint or separate, and showing the classifications, practices, and regulations affecting such charges. 47 U.S.C. § 203.

52. Comments of Pub. Knowledge, Benton Found., & Access Sonoma Broadband at 85, Protecting and Promoting the Open Internet, FCC GN Docket 14-28 (rel. July 15, 2014), *available at* http://apps.fcc.gov/ecfs/document/view?id=7521480282. Many other Title II provisions, including the Section 203 requirements of carriers to report rates, provide consumers with the transparency necessary to protect their interests, whether through legal action or their exercise of buying power. Even in the presence of a competitive market, this transparency is necessary for consumers to take advantage of that competitive market. Without the necessary information to distinguish between providers, consumers are no better off with several providers to choose from. *Id.*

53. There has been some discussion of forbearance, but never a serious outline of a legally-sound algorithm to achieve it. For a cursory, slapstick (yet often cited) discussion of forbearance, *see* Harold Feld, *Title II Forbearance Is Actually So Easy It Makes Me Want to Puke*, WETMACHINE (July 14, 2014), http://www.wetmachine.com/tales-of-the-sausage-factory/title-ii-forbearance-is-actually-so-easy-it-makes-me-want-to-puke.

54. Unfortunately, the Commission is equally guilty in this regard. To wit, in both the Commission's *2010 Open Internet Notice of Inquiry* and again in its *2014 Open Internet NPRM*, the Commission "contemplated that, if it were to classify the Internet connectivity component of broadband Internet access service, it would forbear from applying all but a handful of core statutory provisions—sections 201, 202, 208, and 254—to the service." *2014 Open Internet NPRM*, *supra* note 3, at para. 154; *see also* Framework for Broadband Internet Serv., *Notice of Inquiry*, FCC 10-114, 25 FCC Rcd. 7866, at para. 68 (2010). However, the Commission provides zero specific guidance on how it would use Section 10 to forbear from the tariffing requirements of Section 203. *See id*.

55. 47 U.S.C. § 160 (2012).

concluded that it is the presence of competition in the relevant market that permits forbearance; that is, competition, rather than regulation, is trusted to keep rates just, reasonable, and nondiscriminatory.[56] When the Commission has found competition to be lacking, it has denied forbearance requests.[57] As stated in its *1996 Long Distance Detariffing Order*, in which the Commission forbore from applying Section 203 tariffing requirements to long distance service, the Commission "believe[d] that market forces will generally ensure that the rates, practices, and classifications of non-dominant interexchange carriers for interstate, domestic, interexchange services are just and reasonable and not unjustly or unreasonably discriminatory."[58] It appears that in all forbearance cases regarding Section 203 (if not *all* forbearances cases involving rates), an appeal to competition is made to justify forbearance from tariffing or other statutory mandates.[59]

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56. *See Section 10 Forbearance*, *supra* note 49 and citations therein. After forbearance, the Commission relies upon the complaint process contained in Section 208, 47 U.S.C. § 208, as a regulatory backstop to enforce Section 201 and 202. *See* Orloff v. FCC, 352 F.3d 415, 418 (D.C. Cir. 2003), *cert. denied*, 542 U.S. 937 (2004).

57. *See, e.g.*, Petition of Qwest Corp. for Forbearance Pursuant to 47 U.S.C. § 160(c) in the Phoenix, Arizona Metropolitan Statistical Area, *Memorandum Opinion and Order*, FCC 10-113, 25 FCC Rcd. 8622 (2010) [hereinafter *Phoenix Forbearance Order*], *aff'd*, Qwest v. FCC, 689 F.3d 1214 (10th Cir. 2012).

58. Policy and Rules Concerning the Interstate, Interexchange Marketplace, *Second Report and Order*, FCC 96-424, 11 FCC Rcd. 20730, at para. 21 (1996), *aff'd*, MCI v. FCC, 209 F.3d 760 (D.C. Cir. 2000).

59. A similar result can be found in the Commission's experience in forbearing from Section 203 in the wireless context using its authority under Section 332 of the Communications Act, which contains language very similar to that contained in Section 10. As the Commission observed,

> Concerns about the ramifications of tariff forbearance are unwarranted. Despite the fact that the cellular service marketplace has not been found to be fully competitive, there is no record evidence that indicates a need for full-scale regulation of cellular or any other CMRS offerings. [M]ost CMRS services are competitive. Competition, along with the impending advent of additional competitors, leads to reasonable rates. Therefore, enforcement of Section 203 is not necessary to ensure that the charges, practices, classifications, or regulations for or in connection with CMRS are just and reasonable and are not unjustly or unreasonably discriminatory.

Implementation of Sections 3(N) and 332 of the Commc'ns Act, *Second Report and Order*, FCC 94-31, 9 FCC Rcd. 1411, at para. 174 (1994). The D.C. Circuit in *Orloff* reached a similar conclusion:

> When the common carrier designation fit, the regulatory consequences depended upon the requirements set forth in Title II.

Certainly, an argument can be made that competition in the broadband marketplace could be used to forbear from regulating transactions between BSPs and end users.[60] Those rates aren't regulated today, and we suspect that the Commission is inclined to forbear from retail rate regulation even after reclassification (though forbearance of retail rates may be difficult under the dicta of the *Phoenix Forbearance Order,* the D.C. Circuit's affirmation thereof, and the Commission's recent decision to raise the definition of broadband service to 25 Mbps).[61] As made plain above, however, advocates are making it clear that Net Neutrality is not

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> Much of ''the Communications Act's subchapter applicable to Common Carriers [had been] premised upon the tariff-filing requirement of § 203.'' The Commission reviewed and approved rates and determined what level of profits the regulated carrier would earn. The carrier had to file its rates and make them publicly available; and it could not charge different rates without making a new filing and then waiting for a specified period of time (120 days under § 203(b)(1)). All of that has changed for CMRS …. Rates are determined by the market, not the Commission, as are the level of profits. With § 203 no longer applicable, there is no statutory provision even requiring that the carrier publicly disclose any of its rates, although competition will force it to do so.

See Orloff v. FCC, *supra* note 56, 352 F.3d at 418 (internal citations omitted).

60. Commission Chairman Tom Wheeler, however, apparently believes otherwise. *See* Tom Wheeler, Chairman, FCC, The Facts and Future of Broadband Competition at 1776 Headquarters, Washington, D.C. (Sept. 4, 2014) ("My goal is not to criticize, but to recognize that meaningful competition for high-speed wired broadband is lacking and Americans need more competitive choices for faster and better Internet connections, both to take advantage of today's new services, and to incentivize the development of tomorrow's innovations."), *available at* http://transition.fcc.gov/Daily_Releases/Daily_Business/2014/db0904/DOC-329161A1.pdf.

61. *See In the Matter of Inquiry Concerning the Deployment of Advanced Telecommunications Capability to All Americans in a Reasonable and Timely Fashion, and Possible Steps to Accelerate Such Deployment Pursuant to Section 706 of the Telecommunications Act of 1996, as Amended by the Broadband Data Improvement Act*, FCC 15-10, __ FCC Rcd. __, 2015 BROADBAND PROGRESS REPORT AND NOTICE OF INQUIRY ON IMMEDIATE ACTION TO ACCELERATE DEPLOYMENT (rel. February 4, 2015), *available at* http://transition.fcc.gov/Daily_Releases/Daily_Business/2015/db0206/FCC-15-10A1.pdf. In imaginable scenarios, the regulation of the end-user rates may be necessary to regulate aggressively the termination market. *See generally Phoenix Forbearance Order*, *supra* note 57; Ford and Spiwak, *Section 10 Forbearance, supra* note 49; *see also* Haley S. Edwards, *The New FCC Definition of Broadband Could Change Everything for Comcast*, TIME.COM (January 30, 2015) *available at* http://time.com/3689378/fccs-broadband-comcast-twcs-merger-case ("if the merger is allowed to go through, then a whopping 63% of U.S. households would have only one choice for a broadband Internet provider").

about these retail transactions, but rather the transactions between edge providers and BSPs in the *termination market*. And, in light of the *2010 Open Internet Order*, the *2014 Open Internet NPRM*, and the D.C. Circuit's decision in *Verizon*, the Commission has already determined that the presence of competition is not a viable foundation for forbearance in the termination market. For example, in the *2010 Open Internet Order*, the Commission states:

> [T]hreats to Internet-enabled innovation, growth, and competition do not depend upon broadband providers having market power with respect to end users . . . [b]ecause broadband providers have the ability to act as gatekeepers even in the absence of market power with respect to end users.[62]

The agency is very clear here—*competition does not eliminate the incentive to violate the principles of the Open Internet*. In fact, market power is so irrelevant to the issue that the agency concluded it "need not conduct a market power analysis."[63] If competition does not favorably impact incentives, then competition cannot be used as a basis for forbearance.

Moreover, as noted above, both the Commission and the D.C. Circuit in *Verizon* view BSPs as "terminating monopolists," or monopolists in the *terminating market*.[64] This alleged "terminating monopoly" problem is explicitly addressed in the *2010 Open Internet Order*,[65] by the D.C. Circuit in *Verizon*,[66] and in the *2014 Open Internet NPRM*, where the Commission states that customer switching costs "creat[e] 'terminating monopolies' for content providers needing high-speed broadband service to reach end users."[67] In the presence of a terminating monopoly, competition cannot be used as a basis for forbearance for "terminating services," the exact services the "Open Internet" rules are supposed to be all about. Accordingly, given the Commission's finding that all BSPs are "terminating monopolists" (*i.e.*, each BSP is "dominant" for terminating access to their customers), forbearance from Section 203 does not appear to be a viable legal option.[68]

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62. *2010 Open Internet Order*, *supra* note 16, at para. 32, n. 87.
63. *Id.*
64. The Commission failed to explain why a "terminating monopolist" has chosen, thus far, to charge a zero termination fee. Verizon v. FCC, 740 F.3d 623, 646 (D.C. Cir. 2014); *2010 Open Internet Order*, *supra* note 16, at para. 24.
65. *2010 Open Internet Order*, *supra* note 16, at n. 66.
66. *Id.* at para. 38.
67. *2014 Open Internet NPRM*, *supra* note 3, at para. 42.
68. This is not to say that the Commission cannot change its policy regarding the need to find a degree of competition before it grants forbeaance under Section

V. CONCLUSION

While the Federal Communications Commission has taken a light-touch regulatory approach to broadband Internet access, the agency is coming under intense political pressure to reverse course and reclassify broadband Internet connectivity as a common carrier telecommunications service under Title II in order to protect the "Open Internet." Doing so would permit the Commission to regulate BSPs under Sections 201 and 202 of the Communications Act, which, it is argued, can be used to prevent Broadband Service Providers from establishing slow and fast lanes for the delivery of edge-provider traffic to consumers. Under current case law, the plain terms of the Communications Act, and the Commission's own precedent, it is clear that "reclassification" is more than a political platitude; reclassification invokes significant and complex legal and economic issues which, in turn, require significant and complex implementation, which, in turn, will have "significant consequences for the global development of the Internet."[69]

Specifically, upon reclassification, BSPs would be required to file tariffs under Section 203 of the Communications Act to charge all edge providers (*e.g.*, Netflix, Amazon) a positive price for terminating Internet access. These charges will be distinct from carrier-to-carrier relationships; edge providers are customers of the BSP, not telecommunications carriers. Moreover, because the Commission has found BSPs to be "terminating monopolists" with respect to their customers, forbearance under Section 10 of Section 203's tariffing requirements runs contrary to Commission precedent and, therefore, is not a viable legal option. Accordingly, we do not see how reclassification can avoid applying legacy regulatory frameworks to the Internet, and, in doing so, radically change the economic fabric of the Internet ecosystem. Whether such changes are "good" or "bad" we leave to others to judge.

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10. *See FCC v. Fox Television*, 556 U.S. 502 (2009). However, if the FCC elects to go that route and find that forbearance is acceptable in the face of a monopoly (i.e., *one firm*) in the relevant market, then the agency will have to reconcile that holding with its decisions both (a) to suspend special access regulation where it found that *two firms* were insufficient to warrant degregulation, *In the Matter of Special Access for Price Cap Local Exchange Carriers; AT&T Corporation Petition for Rulemaking to Reform Regulation of Incumbent Local Exchange Carrier Rates for Interstate Special Access Services*, FCC 12-92, 27 FCC Rcd 10557, REPORT AND ORDER (rel. August 22, 2012) *available at* https://apps.fcc.gov/edocs_public/attachmatch/FCC-12-92A1.pdf; and (b) its refusal to grant forbearance of residual undundling obligations, again finding that *two firms* in each relevant market was insufficient to invoke Section 10. *See Phoenix Forbearance Order*, *supra* note 57.

69. *Federal-State Joint Board*, *supra* note 47, at para. 82.