Cable Broadband: Did the Ninth Circuit Beat the FCC to the Punch in Last Mile Regulation?

I. INTRODUCTION

Interstate communications have been regulated by the Federal Communications Commission (FCC) since the Communications Act of 1934. Communications by radio, television, wire, satellite, and cable are regulated by the FCC through a classification scheme most recently updated by Congress with the Telecommunications Act of 1996.[1] The FCC generally classifies industry sectors into three groups: telecommunications, cable, or information services.[2] The classification largely determines what regulatory scheme is applied to the industry.[3] The advent of high-speed Internet services transmitted over copper telephone lines, cable systems, and satellite called into question the FCC's traditional regulatory approach.[4]

In response to technological advances, the FCC issued a Notice of Inquiry (NOI) seeking comment on possible regulatory schemes for high-speed Internet access over cable infrastructure.[5] The FCC specifically sought comment on whether the cable modem service and/or platform should be, for the purpose of regulation, classified as a cable service, a telecommunication service, an information service or some hybrid or new classification.[6] The FCC received approximately 250 comments and met with various industry representatives, consumer advocates and government officials in response to the NOI.[7] On March 15, 2002, the FCC issued a Declaratory Ruling and Notice of Proposed

1. Pub. L. No. 104-104, 110 Stat. 56-161 (1996).
2. *See* Mark A. Lemley & Lawrence Lessig, *The End of End-to-End: Preserving the Architecture of the Internet in the Broadband Era*, 48 UCLA L. REV. 925, 963 (2001).
3. Traditionally the telecommunication sector has been the most regulated. Cable has had minimal regulation and information services have had almost no regulation. *See id.*
4. *See In re* Inquiry Concerning High-Speed Access to the Internet over Cable and Other Facilities, 15 F.C.C.R. 19,287, 19,287 (2000).
5. *See id.* at 19,288.
6. *See id.* at 19,293.
7. *See* Brand X Internet Servs. v. F.C.C., 345 F.3d 1120, 1126 (9th Cir. 2003).

Rulemaking (NPRM) concluding that cable modem services are to be classified as information services, not as cable services or telecommunications services.[8] In the United States Court of Appeals for the Third Circuit, the United States Court of Appeals for the Ninth Circuit, and United States Court of Appeals for the District of Columbia, multiple petitions were filed challenging the FCC's statutory interpretation in the NPRM.[9] None of the seven petitions filed challenged the FCC ruling that cable modem services are properly classified as an information service.[10] Rather, different groups assert that the FCC should have classified cable modem services as an (1) information service and a cable service, or (2) as information service and a telecommunications service, or (3) conferred the classification of an information service upon the DSL sector as well.[11] The Judicial Panel on Multidistrict Litigation transferred the petitions to the Ninth Circuit for review and consolidation.[12] The United States Court of Appeals for the Ninth Circuit *held* that following the rule of *stare decisis*, the portion of the FCC ruling classifying cable modem services as an information service is upheld, but the portion of the FCC ruling that decided cable modems were not part telecommunication services was vacated and remanded for further proceedings. *Brand X Internet Services v. F.C.C.*, 345 F.3d 1120 (9th Cir. 2003).

II. BACKGROUND

Use of the Internet is becoming an everyday fixture in an increasing number of Americans' lives. Over fifty percent of U.S. households had Internet connections as of September 2001.[13] The majority of households subscribe to dial up services over local telephone lines which provide a transfer rate of 56 kbps, in contrast to a cable modem broadband connection that is capable of transfer rates of up to 10 mbps.[14] As more and more content is being offered via the Internet, requiring more bandwidth, demand for broadband Internet access is increasing.[15] Broadband connections are available to seventy-five to eighty percent of

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8. *In re* Inquiry Concerning High-Speed Access to the Internet over Cable and Other Facilities, 17 F.C.C.R. 4798, 4819 (2002) [hereinafter Declaratory Ruling].

9. *Brand X Internet Servs.*, 345 F.3d at 1127.

10. *See id.*

11. *See id.*

12. *See id.*

13. *See* Declaratory Ruling, *supra* note 8, at 4802.

14. *See id.* at 4803.

15. *See* Lemley & Lessig, *supra* note 2, at 926-27. The popularity of audio and video streaming which requires a broadband connection is increasing. *See id.*

all U.S. households.[16] Approximately sixty-eight percent of residential broadband users subscribe to a cable modem service.[17]

Many believe that the Internet's success and growth are attributed to its design principles, including openness of design standards.[18] In essence, the Internet is an "end-to-end" network of interconnected computers that transmit data to the end users. The network is nondiscriminatory in the types of applications that can be created.[19] The creation and "intelligence" of the Internet lie at the end user.[20] For the Internet to function most efficiently, the connections or "pipes" through which the information flows should be as simple as possible.[21] The Internet Service Provider (ISP) creates the connection from the end user to the data "pipes."[22] In addition to providing the connection, ISPs often provide additional services including email.[23] The end user has great variety in the ISP they choose but must connect from their home to the ISP through some system.[24] For the most part, consumers have the choice between cable or DSL services through which they can receive broadband access.[25] This connection between the ISP and the end user is known as the "last mile."[26]

DSL services utilize the existing copper telephone connection to send data over the last mile.[27] This allows DSL service to be deployed quickly and cheaply, although DSL transmissions degrade over distance, so proximity to the "headend" restricts its use.[28] Because DSL services utilize what has traditionally been classified as a telecommunication service to bridge the "last mile," it has been subject to common carrier regulation.[29] Common carrier regulation prevents the owner of the

16. *See* Declaratory Ruling, *supra* note 8, at 4803.
17. *Id.*
18. *See* Lemley & Lessig, *supra* note 2, at 930.
19. *See id.* at 930-31.
20. *See id.*
21. *See id.* at 931.
22. *See id.*
23. *See* Brand X Internet Servs. v. F.C.C., 345 F.3d 1120, 1124 (9th Cir. 2003).
24. *See id.*
25. *See id.*
26. *See id.* at 1124-25.
27. *See* Lemley & Lessig, *supra* note 2, at 927.
28. *See Brand X Internet Servs.*, 345 F.3d at 1124. The "headend" is the place in a traditional telecommunications system where the phone company splits the signal from high density wires into the copper wires that are strung on telephone poles and eventually lead into your home.
29. *Id.* at 1126.

pipeline from leveraging its position to control the actual content of the information transmitted through it.[30]

By contrast, cable modem systems send data through the same coaxial cables that transmit cable television.[31] Most cable providers own or are affiliated with ISPs, thus owning the last mile.[32] The cable company controls all the access between the end user and the Internet, giving them the "power to restrict other ISPs' access to cable subscribers."[33]

Because of their structure, cable modem services do not fit neatly into one of the FCC's three classifications.[34] The Telecommunications Act of 1996 (Act) defines "cable service" as: "(A) the one-way transmission to subscribers of (i) video programming, or (ii) other programming service, and (B) subscriber interaction, if any, which is required for the selection or use of such video programming or other programming service."[35] The Act defines "telecommunications service" as "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."[36] Finally, "Information service" is defined as "the offering of a capability for generating, acquiring, storing, transforming, processing, retrieving, utilizing, or making available information via telecommunications, and includes electronic publishing, but does not include any use of any such capability for the management, control, or operation of a telecommunications system or the management of a telecommunications service."[37]

The United States Supreme Court recognized the difficulty in classifying cable modem services when deciding a challenge of a FCC ruling concerning the regulation of telephone pole leasing rates.[38] Although the Court recognized the problem, the majority was able to sidestep classifying cable modem services by determining that they would have arrived at the same decision regarding pole leasing regardless of the classification.[39] In his dissent, Justice Thomas chided the FCC for asking the Court to sustain the FCC's authority to regulate cable

30. *See id.*
31. *See id.* at 1124.
32. *Id.*
33. *Id.* at 1125.
34. *See id.* at 1126-28.
35. 47 U.S.C. § 522(6) (2000).
36. *Id.* § 153(46).
37. *Id.* § 153(20).
38. *See* Nat'l Cable & Telecomms. Ass'n v. Gulf Power Co., 534 U.S. 327, 338 (2002).
39. *See id.* at 338-39.

broadband without articulating the specific statutory basis for such a decision.[40] The dissent recognized that cable modem services could be classified in more than one category particularly because of the two step process involved: (1) the transmission of the data from the end user to the ISP and (2) the transmission of data from the ISP to Internet backbone.[41]

In deciding whether a county's Internet open access requirement was preempted by federal law, the United States Court of Appeals for the Fourth Circuit came closer to classifying cable modem services.[42] Henrico County conditioned its approval of the sale of MediaOne's cable television and modem franchise to AT&T upon the cable modem services remaining open access.[43] MediaOne argued that the Communications Act preempted the county's mandate.[44] The Communications Act prohibits a franchising authority from requiring a cable operator to provide telecommunications services or facilities as a condition for the transfer of the franchise.[45] In order for the court to determine if there was preemption, it had to decide if the cable modem franchise fit the category of a telecommunications service or facilities.[46] The court held that when MediaOne transmits data, the last mile between the end user and the ISP, it is a pipeline for telecommunications and properly classified as a telecommunications facility because it transmits "'information of the user's choosing, without change in the form or content.'"[47] The court stopped short of classifying cable modem services as telecommunication services.[48] The court recognized that cable modem services could be classified as a combination of cable service, telecommunications service or information service, but refused to make the decision noting the significant regulatory consequences.[49]

The Ninth Circuit decided a similar cable franchise case.[50] In *AT&T Corp. v. City of Portland*, the question was whether a local government could force a cable company to grant unrestricted access to

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40. *See id.* at 350-51 (Thomas, J., concurring in part and dissenting in part).
41. *See id.* at 352 n.4 (Thomas, J., concurring in part and dissenting in part).
42. *See* MediaOne Group, Inc. v. County of Henrico, 257 F.3d 356, 364-65 (4th Cir. 2001).
43. *See id.* at 363.
44. *Id.* at 360.
45. 47 U.S.C. § 541(b)(3)(D) (2000).
46. *See MediaOne Group*, 257 F.3d at 363-64.
47. *Id.* at 363 (quoting 47 U.S.C. § 153(43)).
48. *See id.* at 363-64.
49. *See id.* at 364-65.
50. *See* AT&T Corp. v. City of Portland, 216 F.3d 871 (9th Cir. 2000).

its cable modem service as a condition for the transfer of the franchise.[51] The determinative issue in the case was the court's classification of the cable modem systems.[52] To make this determination, the court looked to the plain language of the Communications Act.[53] The court first looked to the definition of a cable service and determined that the two-way interactive nature of a cable modem service clearly does not fit into the definition of a cable service.[54] If the court were to force broadband cable into the traditional cable service classification, it would lead to absurd results and "'simply make[] no sense in any respect, and would be infeasible in many respects.'"[55] The court ruled that because the cable modem service did not fall within the Act's definition of a cable service, the local government may not regulate it through cable franchise agreements.[56]

The court went on to determine what classification scheme a cable modem system best fits.[57] The court started its analysis by breaking cable modem service into two elements.[58] The first element is the actual data that flows through the pipeline, and the second is the pipeline itself.[59] The first element is properly classified as an information service in that it is an "'offering of a capability for generating, acquiring, storing, transforming, processing, retrieving, utilizing, or making available information via telecommunications.'"[60] Unlike other broadband services, cable modem services control the second element: the last mile transmission facilities between the ISP and the end user.[61] Regardless of ownership, a cable modem service is merely using the last mile transmission facilities in the same manner as DSL or traditional dialup ISPs, to send information to the end user.[62] The information sent is of the user's choosing without any change in form or content.[63] This fits the definition of telecommunications, so offering the service must be telecommunications services.[64] The court reasoned that just because a

51. *See id.* at 873.
52. *See id.* at 876.
53. *See id.*
54. *See id.* at 876-77.
55. *Id.* at 877 (quoting Nat'l Cable Television Ass'n v. F.C.C., 33 F.3d 66, 75 (D.C. Cir. 1994)).
56. *Id.*
57. *See id.* at 877-79.
58. *See id.* at 877-78.
59. *See id.*
60. *See id.* at 877 (quoting 47 U.S.C. § 153(20) (2000)).
61. *See id.*
62. *See id.* at 878.
63. *See id.*
64. *See id.*

cable modem service owns both the ISP and the last mile pipeline, the pipeline does not cease to be classified as a telecommunications service.[65] The court found this outcome consistent with the overall regulatory scheme set forth in the Telecommunications Act, which regulates competing DSL service as a telecommunications service subject to common carrier obligations.[66] As a result of these cases, the FCC felt the need to make a ruling on how cable modem services are classified and to form a national policy. This rulemaking led to the noted case.[67]

III. THE COURT'S DECISION

In the noted case, the petitioners challenged the portion of the FCC rule that conflicts with the Ninth Circuit's earlier decision.[68] At the outset, the court described the technological nature of cable modem services, again emphasizing the two elements, information and telecommunications services.[69] Recognizing that they were bound by the precedent established in *Portland*, the court analyzed that holding in some detail.[70]

Normally, when a court reviews an agency interpretation of a statute, they apply the test in *Chevron U.S.A., Inc. v. Natural Resources Defense Council, Inc.*[71] However, if a court had previously interpreted the statute, then it is bound by its earlier interpretation.[72] The court pointed to the established law that three-judge panels are bound by the holdings of other three-judge panels.[73] However, the Ninth Circuit provides an exception to the rule when its precedent conflicts with a subsequent agency interpretation.[74] For the court to adopt the agency's interpretation, the court's earlier decision must have adopted the deferential review of the agency's interpretation of the statute.[75] Therefore, if the agency's decision was unreasonable or if the court held that its interpretation was the sole permissible one, then the court's

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65. *Portland*, 216 F.3d at 878.
66. *See id.* at 879.
67. *See* Brand X Internet Servs. v. F.C.C., 345 F.3d 1120, 1124-27 (9th Cir. 2003).
68. *See id.* at 1123.
69. *See id.* at 1124-25.
70. *See id.* at 1128-30.
71. 467 U.S. 837 (1984); *Brand X Internet Servs.*, 345 F.3d at 1128-29.
72. *Brand X Internet Servs.*, 345 F.3d at 1128-29.
73. *See id.* at 1130 (citing United States v. Camper, 66 F.3d 229, 232 (9th Cir. 1995)).
74. *See id.*
75. *See id.* at 1130 (quoting Mesa Verde Constr. Co. v. N. Cal. Dist. Council of Laborers, 861 F.2d 1124, 1136 (9th Cir. 1998) (en banc)).

precedent trumps any subsequent agency interpretation.[76] The court found in *Portland* that the FCC had "'declined, both in its regulatory capacity and as amicus curiae, to address the issue.'"[77] The court therefore reviewed the matter with no deferential view towards agency decision making.[78]

The court held that because they had previously concluded that cable modem services were part information service and part telecommunications service, they were bound by this decision.[79] In so much as the FCC's NPRM agreed that the cable modem systems are information services, the *Declaratory Ruling* stood, but the portion of the NPRM that disagreed with the court's conclusion in *Portland*, that a cable modem service is also a telecommunications service, was vacated.[80]

There were two concurring opinions to the noted case. Judge O'Scannlain asserted his belief that the court was correct in its holding on the basis of *stare decisis*, but lamented the strange result it produced, in that a three judge panel "beat the FCC to the punch" and told an agency "acting within the area of its expertise" that the agency's interpretation was wrong.[81]

Judge Thomas, in his concurring opinion, also agreed that the court was bound by its holding in *Portland*.[82] He argued that even if the court was not so bound, the court's review of the FCC's statutory interpretation does not implicate *Chevron* deference.[83] The court need only look to *Chevron* when Congress has not spoken directly to the issue.[84] Judge Thomas felt that in the Telecommunications Act Congress meant what it said in defining "telecommunications" and thus found no ambiguity in the statute open for interpretation.[85] Therefore, if the court were to review the FCC interpretation of the statute, they would reach the same conclusion: the second element of cable modem services fits clearly within the statutory definition of telecommunications services.[86] The definition of information service necessarily included transmission of the

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76. *See id.* at 1130-31 (citing *Mesa Verde Constr.*, 861 F.2d at 1136).

77. *Id.* at 1131 (quoting AT&T Corp. v. City of Portland, 216 F.3d 871, 876 (9th Cir. 2000)).

78. *See id.*

79. *Id.* at 1132.

80. *Id.*

81. Brand X Internet Servs. v. F.C.C., 345 F.3d 1120, 1132-33 (9th Cir. 2003) (O'Scannlain, J., concurring).

82. *See id.* at 1134 (Thomas, J., concurring).

83. *Id.* (Thomas, J., concurring).

84. *Id.* (Thomas, J., concurring).

85. *See id.* at 1135-40 (Thomas, J., concurring).

86. *See id.* at 1140 (Thomas, J., concurring).

information via telecommunication services.[87] If the cable modem service is classified as an information service and it owns the last mile connection, then it must by definition also provide telecommunications services.[88]

Judge Thomas argued that the two element classification fits squarely with the FCC's regulatory scheme.[89] He contended that the FCC did the same when a telephone company also owned an ISP.[90] The ISP is regulated as an information service, while the sending of the data from the ISP to the end user was telecommunications service subject to common carrier restrictions.[91] This scheme enabled the FCC to leave ISPs largely unregulated to promote competition for "enhanced services" by ensuring end users had access to the ISPs by imposing common carrier obligations.[92]

IV. ANALYSIS

The noted case vacated the FCC's interpretation through the "bizarre" scenario described by Justice Scalia whereby the interpretation of an agency empowered by Congress is vacated because the agency failed to act before the issue was presented to the courts.[93] This is not the only strange twist in the case. In the case law leading up to the noted case, cable companies were fighting to prevent the local cable franchising authorities from requiring them to open their cable modem pipeline to competing ISPs. In the fight to keep their pipelines closed to competition, the cable companies argued that they were not offering traditional cable services, but something not regulated by the franchising authorities. This argument opened the door and forced the courts to rule before the FCC made its interpretation. The courts' rulings, while not allowing franchising authorities to condition sale of cable franchises upon open access, ultimately led to cable modem services being partly classified as telecommunications services. This classification brought with it the common carrier obligations that cable companies were seeking to avoid in the first place.

Despite the odd way the court arrived at its holding, the decision fits within the current regulatory scheme. Congress sought to provide a pro-

87. *See id.* (Thomas, J., concurring).
88. *See id.* (Thomas, J., concurring).
89. *See id.* at 1138-39 (Thomas, J., concurring).
90. *See id.* (Thomas, J., concurring).
91. *See id.* (Thomas, J., concurring).
92. *See id.* (Thomas, J., concurring).
93. *See* United States v. Mead, 533 U.S. 218, 247 (2001) (Scalia, J., dissenting).

competitive policy framework designed to promote advanced telecommunications by opening markets.[94] The "holy grail" of Internet service is broadband.[95] As more content on the Internet requires a broadband connection, access to the broadband pipeline will become more vital to maintaining the open nature of the Internet. Without open access, the end user will be forced to use the ISP of the last mile owner. This will greatly stifle competition among ISPs who offer advanced services. The two element regulatory scheme put forth by the court solves this problem by subjecting the last mile pipeline to common carrier obligations, while leaving the ISPs virtually unregulated and free in the quicksilver market to adapt and compete. It can be argued that if cable modem services are not open, an alternative technology will emerge to compete. While this is possible, satellite and DSL services have yet to reach the technological level to where they are as available as cable modem services. In addition, if cable modem services are unregulated they can charge a monopolist price for the service and still charge less than the marginal cost for a competitor to develop a competing system because the cable system has an expensive infrastructure already in place.

One of the underlying purposes of Congress granting cable franchises to cable operators without imposing the same common carrier obligations was to encourage the cable companies to make great initial capital expenditures. If cable modem systems are to only be classified as information systems and not subject to common carrier obligations, the cable system will receive a windfall. Consequently, society subsidized, through decreased competition, the capital outlay for the cable pipeline. Allowing the cable companies to operate in a monopolistic manner by controlling access to the pipeline for broadband services was not part of their bargain with society.

This said, is this the case of two different ideological views on regulation and First Amendment aspects of the Internet driving the decision? Are the FCC and the Ninth Circuit not really interpreting the statutes, but determining a regulatory scheme and forcing cable modem services into the classification that mandates that scheme? The Ninth Circuit appears to have the most logical statutory argument, but the FCC is planning to appeal. Regardless of the final outcome, the Ninth Circuit's decision may create a situation that Judge O'Scannlain had earlier predicted:

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94. H.R. CONF. REP. NO. 104-458, at 113 (1996).

95. *See* Lemley & Lessig, *supra* note 2, at 926.

> Given the importance of the regulatory classification of broadband internet service, one wonders whether our decision today will prompt the FCC to follow the example of the Social Security Administration, the National Labor Relations Board, and the Internal Revenue Service, among other federal agencies, in adopting a policy of "nonacquiescence" in the face of court rulings with which the agency disagrees.[96]

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96. Brand X Internet Servs. v. F.C.C., 345 F.3d 1120, 1133 n.1 (9th Cir. 2003) (O'Scannlain, J., concurring).

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