July 1, 2005

bandwidth

An Online Newsletter of Discovery Institute

Alice in Cableland; Grokster in Fableland

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Author's Note

Bandwidth readers have seen one issue in 2005 prior to this one. Please be advised that *Bandwidth* will become at most a quarterly publication hence. The author is creating a weblog, to be sponsored by Discovery Institute, entitled *Letter From The Capitol* (www.letterfromthecapitol.com), slated to be launched publicly this fall. It will cover a broad spectrum of public policy, including telecom issues not covered in future issues of *Bandwidth*. This edition of *Bandwidth* discusses two decisions of the United States Supreme Court, both released June 27. The first held that cable providers, unlike telephone companies, cannot be forced to offer Internet access to their competitors. The second held that "peer-to-peer" network providers who knowingly aid copyright infringement can be held liable by copyright owners.

Alice in Cableland

> 'When I use a word,' Humpty Dumpty said, in a rather scornful tone, 'it means just what I choose it to mean, neither more nor less.'
>
> 'The question is,' said Alice, 'whether you can make words mean so many different things.'
>
> 'The question is,' said Humpty Dumpty, 'which is to be master - that's all.'
>
> Alice was too much puzzled to say anything; so after a minute Humpty Dumpty began again. 'They've a temper, some of them - particularly verbs: they're the proudest - adjectives you can do anything with, but not verbs - however, I can manage the whole lot of them! Impenetrability! That's what I say!'
>
> 'Would you tell me, please,' said Alice, 'what that means?'
>
> 'Now you talk like a reasonable child,' said Humpty Dumpty, looking very much pleased. 'I meant by "impenetrability" that we've had enough of that subject, and it would be just as well if you'd mention what you mean to do next, as I suppose you don't mean to stop here all the rest of your life.'
>
> 'That's a great deal to make one word mean,' Alice said in a thoughtful tone.
>
> 'When I make a word do a lot of work like that,' said Humpty Dumpty, 'I always pay it extra.'
>
> 'Oh!' said Alice. She was too much puzzled to make any other remark."[1]

What else can one say about the Supreme Court's June 27 ruling in *National Cable Telecommunications Association v. Brand X Internet Services*? Therein the majority overturned an eminently sensible decision of the Ninth Circuit that had rejected the FCC's strained attempts to define cable modem service as outside the realm of the 1996 Telecommunications Act's definition of what constitutes telecommunications services. By doing so the Supremes affirmed the FCC's longstanding policy of forcing telephone companies to provide network access to Internet access competitors, while declining to force cable companies to do likewise for their Internet access competition. The full import of what the court has done was captured perfectly in Justice Scalia's dissent, wherein he cites the FCC order at issue as an example of "Möbius-strip reasoning [that] mocks the principle that the statute constrains the agency (the Federal Communications Commission—FCC) in any

meaningful way."[2]

Majority and Concurring Opinions

Begin, however, with the majority's holding, written by Justice Thomas (joined by Chief Justice Rehnquist and Justices Stevens, O'Connor, Kennedy and Breyer). Thomas begins with the ace of trumps for regulatory agencies seeking judicial affirmation of their rulings, the so-called "*Chevron* deference" judicial doctrine, under which reviewing courts are to uphold any reasonable construction of an ambiguous statute by an administrative agency, even if the court would prefer a different statutory interpretation.

To reach this result, Thomas reviewed the FCC's elaborate regulatory edifice, constructed over the past four decades, to justify different regulatory treatment of telephone and data processing services—essentially, continued imposition of comprehensive common-carrier regulation of telecommunications ("basic services" in FCC-speak) with limited liberalization, while minimally regulating data processing services ("enhanced services" in FCC-speak).[3]

At issue before the Supremes this time was a 2002 Declaratory Ruling by the FCC that broadband Internet services provided over cable modem are not telecommunications within the meaning of the 1996 Act, while identical service provided over telephone lines remains telecommunications service. Justice Thomas cites the FCC's explanation: "Its logic was that, like non-facilities-based ISPs (Internet Service Providers), cable companies do not 'offe[r] telecommunications service to the end user, but rather…merely us[e] telecommunications to provide end users with cable modem service."[4]

The FCC's intellectual gymnastic affirmed by the majority is that cable modem service includes telecommunications, but is not mere telecommunications as it includes Internet-based services, and that cable firms offer Internet service but do not offer telecommunications. To reach this the FCC resorted to its long-running regulatory classification of basic and enhanced service, with telecommunications the former and data services the latter. Thomas accepts this as a reasonable interpretation of ambiguous statutory language and thus to be sustained under *Chevron* deference.

Thomas then turns to MCI's argument that telephone-company provided Digital Subscriber Line (DSL) service should be treated the same way for regulatory purposes as cable modem service. DSL is regulated so that non-telco competitors providing DSL get access to the phone company's line, while cable modem providers need not offer such "forced access." Thomas notes that the FCC justified imposing forced access on DSL providers by reference to the historical status of telephone networks, without regard

to "contemporaneous market conditions"; the FCC's declining to subject cable modem service to similar rules is justified, Thomas says, by "changed market conditions." Of this pairing, Thomas says: "We find nothing arbitrary about the Commission's providing a fresh analysis of the problem as applied to the cable industry, which it has never subjected to these rules."[5]

Justice Breyer filed a brief concurring opinion, in which he said he joined the majority "because I believe that the Federal Communications Commission's decision falls within the scope of its statutory authority—though perhaps just barely."[6]

Dissenting Opinion

Justice Scalia filed a dissenting opinion, partly joined by Justices Souter and Ginsburg.[7] He points out that the majority's position—and the FCC's—is that cable companies do not "offer" high-speed access to the Internet via cable modem; rather they offer "applications and functions" integrated with same. Put another way, because Internet access is not a stand-alone offering the companies are, in the FCC's regulatory world, not "offering" the service within the meaning of the 1996 Act.

To this Scalia replies that under what passes for reasoning by the FCC, a customer who calls up a pizzeria and asks that a pizza be delivered is told by the pizzeria that pizzas, but not their delivery, are being sold. The customer, Scalia argues, would perceive that the pizzeria does in fact offer delivery and think any other construction "crazy."

Things get worse, for Scalia refers to the FCC's having reserved in its ruling the right to use its regulatory authority in the future to impose Title II-type common carrier access rules on cable companies by using its Title I "ancillary" regulatory power. In other words, having stated in its current order that cable companies cannot be regulated under Title II common carriage, the agency reserves the right to do so under its Title I ancillary authority—although the FCC could then decide to exercise its authority to "forbear" from imposing such rules.

This is too much for Scalia, who wryly observes: "In other words, what the commission hath given, the commission may well take away—unless it doesn't. This is a wonderful illustration of how an experienced agency can (with some assistance from credulous courts) turn statutory constraints into bureaucratic discretions."[8]

Assessment

After having its wings clipped several times by the Supremes over the past decade, this time the FCC struck gold. It can force telephone companies to offer Internet service competitors access based upon the history of telephony, without regard to current market conditions; it can decline to force cable companies to offer

access to competitors for same, based upon current market conditions and without regard to the history of cable. It can treat phone companies as common carriers under Title II common carrier authority; it can impose common carriage on cable companies under Title I ancillary authority, or it can decline to do so. It can say that phone companies "offer" Internet service over telephone lines while offering telecommunications separately; it can say that cable modem service is so integrated with the underlying telecommunications conduit that the cable company does not "offer" telecommunications separately.

So the FCC gets to pervasively regulate telephone companies based upon their historic status as regulated monopolies, while ignoring cable's historical status as far less-regulated monopolies. When the 1996 Act was signed, the seven largest Cable MSOs—Multiple System Operators—had 85 percent of the entire cable market, more than the 80 percent share held by the seven Regional Bell Operating Companies as of the 1984 AT&T divestiture. And more than 99 percent of cable franchises had no competitors in their serving areas. That cable modem service has a larger market share than telephone-company provided DSL the FCC can ignore. True, common carriage rules have historically been based upon telephony being considered an "essential" service, a status not applied to cable. However, that historical distinction has zero relevance to the competition for broadband services in today's market; that cable has a greater market share shows that the phone companies cannot dominate the Internet service market by leveraging their market position in telephony.

So the FCC gets to decide which history it wants to ignore and which market changes it wants to ignore. And it gets to ignore that there is *zero* substantive difference between, say, a cable modem line connected to an end user's PC, and a DSL line connected the same way. Alice, come to Cableland and discover wonders that not even the vivid imagination of Lewis Carroll could encompass.

Grokster in Fableland

If the Supremes were in outer space, metaphorically, in the cable modem case, they were on *terra firma* in the copyright infringement case involving the use of peer-to-peer networks for unauthorized distribution of copyrighted works, *Metro-Goldwyn-Mayer Studios v. Grokster*; it was the defendants who dwelled in another dimension. A unanimous Court held that Grokster and StreamCast, both peer-to-peer network providers, not only were aware of substantial infringing use via their product but actively encouraged such use, with full knowledge of the damage they thus were inflicting on plaintiffs.

Defendants distributed software intending to promote copyright infringement and were held "vicariously" liable for massive unlawful use by their customers, despite potential

lawful uses. Some 90 percent of peer-to-peer downloads are estimated to be illegal. Unlike in the 1984 Sony Betamax case, where the primary use of taping was lawful (time-shifting), here the primary use—known by defendants—is copyright infringement by downloading for free works intended for commercial sale. Defendants not only were aware of prior copyright infringement Internet software (*i.e.*, Napster); they sought to emulate their precursors. Defendants did not develop filters. Indeed, they sold advertising space by viewer volume and thus profited from infringing use on a "gigantic scale." Justice Souter's opinion said: "The record is replete with evidence that from the moment Grokster and StreamCast began to distribute their free software, each one clearly voiced the objective that recipients use it to download copyrighted works, and each took active steps to encourage infringement."[9]

Assessment

This case is unusually cut-and-dried. If you create a product to facilitate illegal acts and encourage commission of same, do not expect much sympathy from the courts. Future prospective facilitators of piracy will at least have to be more circumspect.

Conclusion

The Supreme Court's twin June 27 rulings accomplished one good thing and one potentially very bad one. The good news is that copyright infringers will have to be more careful in the future. While an earlier issue of *Bandwidth* argued that Congress and the courts have struck a balance too far in favor of copyright owners[10], outright piracy cannot be defended. New technologies that facilitate same will force market changes, and the regulatory balance will need adjustment to keep the interests of copyright owners and market users in equipoise.

The bad news is that the Supremes, in the *NCTA v. Brand X Internet Services* case, gave sweeping power to the FCC to do pretty much what it wants in terms of promulgating rules for competition in Internet services. Only once before did the Court give the agency such latitude, in the curious decision upholding the FCC's TELRIC cost standard. Thus the FCC substituted a cost standard based upon hypothetical network cost for one based upon actual cost, in defiance of any reasonable interpretation of the 1996 Act's wording.

To be fair, many traditional phone-firm supporters consider the ruling positive because it did not force cable access. But affirmation of the Ninth Circuit would merely have forced the FCC to choose between deregulating phone companies or re-regulating cable. The latter course would not survive judicial review.

The case returns to an FCC in transition. The new chairman, Kevin Martin, has less passion for deregulation than did his predecessor, Michael Powell. The other strong

pro-deregulation commissioner, Kathleen Abernathy, is departing. This leaves two pro-regulation Democrats (Michael Copps and Jonathan Adelstein) on board. The White House, for its part, shows no sign of serious interest in telecom policy. With other distractions (war, Social Security, tax reform) occupying its attention it wants no headaches from the FCC. Martin's predecessor was willing to rile the media and Congress in pursuit of his policy goals. Do not expect this from Martin. Lacking Powell's passion for deregulation he is likely to keep a lower political profile and run a tight ship. The easiest way for the agency to stay out of the news is, of course, to eschew major moves towards greater deregulation.

What will it take to wake up US telecom policymakers? Look East. China graduates 160,000 students with advanced university degrees, four times the US number; by 2008 China will have an estimated 500 million cellphone users.[11] As information technology leadership moves eastward to the Orient, eventually US policymakers will receive a rude awakening. Evidence of changing domestic market conditions has not convinced the Commission to deregulate telephone company provision of Internet access. It likely will take evidence of global market changes to prod the FCC to deregulate DSL. FCC telecom policy, if unchanged, will not look so smart then. Then again, it does not look so smart today, either.

(Endnotes)

[1] Lewis Carroll, *Through the Looking Glass*. < http://sundials.org/about/humpty.htm >

[2] *National Cable Telecommunications Association v. Brand X Internet Services* (*NCTA v. Brand X*), dissenting slip opinion, p. 11.

[3] The FCC regulates telephone companies under Title II of the 1996 Act, which supplanted Title II of the Communications Act of 1934; Title II covers common carriers with a pervasive scheme of regulation. Internet services are regulated under Title I "ancillary" authority, and are minimally regulated.

[4] *NCTA v. Brand X*, fn. 2 *supra*, majority slip opinion, p. 7

[5] *Id.*, p. 30.

[6] *Id.*, slip opinion of Justice Breyer, p. 1. (Justice Stevens filed a single-paragraph separate concurrence on a technical legal point not germane to telecommunications and thus outside the scope of this analysis.)

[7] Souter and Ginsburg joined in Scalia's telecom regulatory analysis, but not on the second part of Scalia's dissent, which covers administrative law issues extraneous to telecom and thus not germane here.

[8] *NCTA v. Brand X*, fn. 2 *supra*, dissenting slip opinion of Justice Scalia, p. 10.

[9] *Metro-Goldwyn-Mayer v. Grokster*, majority slip opinion, p. 6.

[10] *Hollywood and Thine: Are PVRs Property of Video & Recording Studios?* (Dec. 12, 2003). < http://www.discovery.org/scripts/viewDB/index.php?command=view&program=Technology%20and%20Democracy%20-%20Bandwidth&id=1674 >

[11] *The Rise of a New Power*, US News & World Report, p. 40 (June 20, 2005).

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