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by

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Like "Voldemort" to wizards, "rate regulation" is the name reclassification enthusiasts dare not speak when describing Title II. It conjures up images of government bureaucrats interfering in the market to decide which services providers can offer to customers and at what price—a politically unpopular image at odds with a dynamic Internet ecosystem. For this reason, since his eleventh-hour conversion under White House pressure, FCC Chairman Tom Wheeler has repeatedly insisted that "there will be no rate regulation" under his Title II reclassification plan.[1]

But these fervent protests cannot change the fact that Title II reclassification *is* rate regulation—a fact that FSF President Randolph May has made repeatedly throughout the net neutrality debate. This truth is self-evident even from the handful of details that Chairman Wheeler has released before the Commission's fateful vote. More fundamentally, Title II, at its heart, is a rate regulation regime: Section 201(b) requires common carriers to charge only just and reasonable rates. And Section 202(a) makes it unlawful to make any unjust or unreasonable discrimination in charges. The Commission may avoid the most onerous forms of rate regulation such as tariffing and unbundling. But as the arbiter of Section 201 and 202 violations, the Commission will be forced into accepting the mantle of America's *de facto* regulator of broadband rates—and its recent ham-handed decisions about broadband competitiveness will dramatically limit its flexibility in this role.

As an initial matter, the Commission's own Open Internet fact sheet belies the claim that it will not regulate rates for broadband service. One of the three primary pillars of the proposed order is a prohibition on "paid prioritization," meaning that "broadband providers may not favor some lawful Internet traffic over other lawful traffic in exchange for consideration."[2] While this prohibition is an essential tenet of most net neutrality proposals, its effect is to set a specific rate—namely $0—for priority delivery over last-mile broadband networks. The fact sheet also claims authority to review and, if necessary, enjoin terms of interconnection agreements between broadband providers and other parts of the Internet ecosystem, which would presumably include review of rates that ISPs charge for paid peering or transit service.

Chairman Wheeler may respond that he meant the Commission would not regulate *retail* broadband rates, the price that consumers pay for broadband service. This is a somewhat artificial distinction, as Title II has long governed interconnection rates between networks as well as retail rates to consumers.[3] But even under this narrow consumer-focused definition of rates, reclassification will necessarily lead to rate regulation by the Commission, because Title II is fundamentally a rate regulation regime.

The heart of Title II common carriage is Sections 201 and 202. Section 201(b) mandates that "[a]ll *charges*, practices, classifications, and regulations for and in connection with [] communication service, shall be just and reasonable; and that any such *charge*, practice, classification, or regulation that is unjust or unreasonable is declared to be unlawful."[4] Similarly, Section 202(a) makes it "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 service" or to "make or give any undue or unreasonable preference to any particular person, class of persons, or locality."[5] Section 208 allows any aggrieved party to file a complaint alleging that a carrier violated a duty under the Act, including Sections 201 and 202. If the carrier fails to redress the complaint promptly, Section 208 declares that "it shall be the *duty* of the Commission to investigate the matters complained of."[6] The statutory language simply does not allow the Commission to be a disinterested observer of communications rates as Chairman Wheeler suggests. Rather, it not only invites but demands that the Commission intervene in the market, at least upon request, to pass judgment regarding whether individual carrier rates are just and reasonable.

Admittedly, the Commission has proposed forbearing from the most aggressive forms of rate regulation that would otherwise be at its disposal, such as tariffing and mandatory unbundling of network elements.[7] While these are welcome announcements, they should surprise no one. The Commission has aggressively opposed tariffing of most telecommunications services for several decades.[8] And a multiyear litigation battle over pricing of unbundled network elements[9] ultimately ended in regime widely considered a failure that no one should be eager to repeat.[10]

But courts and the Commission have repeatedly emphasized that forbearing from tariffing does not mean the Commission has foresworn oversight of carrier rates. The D.C. Circuit Court of Appeals discussed the distinction in *Orloff v. Federal Communications Commission*,[11] a case alleging that a Verizon Wireless rate constituted unreasonable discrimination. The court noted that historically, the Commission assessed whether a rate was just or reasonable "largely … by reference to the carrier's tariff."[12] Through forbearance, Congress and the Commission "dissolved what the Supreme Court described as the 'indissoluble unity' between § 203's tariff-filing requirement and the prohibition against rate discrimination in § 202."[13] But even in an untariffed environment, carriers "still have duties," including compliance with Sections 201 and 202, meaning its rates were still subject to Commission review in the event of a complaint.[14] The Commission "emphasize[d]" that it "is not forbearing from applying section 202(a)" and that even in a light-touch regulatory regime "section 202 continues to act as a powerful protection for…consumers."[15] It vowed to that the Commission "will not hesitate to find that unreasonable discrimination violates section 202."[16]

Orloff is a helpful case study in part because it occurred in the context of the untariffed wireless market, which Chairman Wheeler has repeatedly analogized to his proposed broadband rules. In 2000, Verizon Wireless customer Jacqueline Orloff filed a complaint with the Commission alleging that the carrier violated Sections 201 and 202 by offering discounts and other inducements to certain wireless customers to entice them to join or stay with Verizon Wireless.[17] Orloff's complaint focused on the carrier's willingness to allow customers to haggle for better deals. In essence, she asserted that those who haggled got a better price than non-hagglers for the same service, which constituted unreasonable discrimination under Section 202(a) and therefore was an unjust or unreasonable practice under Section 201(b).[18]

Importantly, the Commission did not simply dismiss the complaint on the grounds that it did not regulate wireless rates. Rather, it applied the same three-part test developed during the era of tariffing to determine whether Verizon discriminated unjustly or unreasonably among its customers.[19] Under the first two steps, the complainant must show that the services at issue are "like" services, and if so, that there are differences in the terms and conditions pursuant to which the services are provided. In this case, the Commission found that by granting concessions to customers who haggle, Verizon Wireless effectively charged different rates for the same service and therefore that the company discriminated against customers like Orloff who did not haggle as effectively. The burden then shifted to Verizon Wireless under step three to prove that its discrimination was reasonable.

Orloff also helps illustrate the limits of wireless as an analogy to Chairman Wheeler's proposed reclassification of broadband. Ultimately, the Commission held that although Verizon's sales concessions resulted in discrimination, this discrimination was reasonable because of the competitiveness of the wireless market in Orloff's native Cleveland. The Commission explained:

> [W]e decline to find that Defendants' concessions practices violated section 202(a) of the Act, even if those practices allowed some consumers to negotiate better deals than other consumers…because we find that market forces protect Cleveland consumers from discrimination from these particular practices. We find that there is no evidence that any market failure prevented customers from switching carriers if they were dissatisfied. Accordingly, we find it unlikely that a carrier would have an incentive to engage in unreasonable discrimination where such conduct would result in a loss of customers.[20]

In other words, the Commission avoided a searching review of Verizon's wireless rates because of its faith that competition would discipline market players and prevent carriers from engaging in unjust or unreasonable behavior. The D.C. Circuit upheld the Commission's decision on this ground, noting that "the generality of these terms—unjust, unreasonable—opens a rather large area for the free play of agency discretion" and that the Commission was "entitled to value the free market" when deciding whether a practice is reasonable.[21]

Once the Commission reclassifies broadband under Title II, one can imagine a similar complaint arising in the broadband context. As in the wireless market, sales concessions are a common practice to entice broadband customers to join or remain on a particular company's network. Comcast, Verizon, and others often offer low introductory rates for broadband service or "triple play" bundles of broadband, cable, and telephone services which are unavailable to existing customers. And numerous websites are dedicated to helping customers whose service contracts are expiring to haggle in pursuit of a better deal than the company's standard packages. Under *Orloff*, the Commission is likely to find that these concessions constitute discrimination under Section 202(a). And even the company's standard rates could be vulnerable to a challenge that they are unjust or unreasonable under Section 201(b).

But the Commission's recent rhetoric about the lack of competition in broadband markets limits its ability to conclude, as it did in *Orloff*, that competition obviates the need for an aggressive Commission investigation to determine whether the challenged rates are reasonable. In January 2015, the Commission raised its definition of "broadband service" from 4Mbps down and 1Mbps up to 25Mbps down and 3Mbps up.[22] As Commissioner Pai noted in dissent, the report offered little justification for this benchmark, which few consumers purchase even when they have the opportunity to do so, and which is at odds with the Commission's own 10 Mbps down benchmark for subsidizing broadband to rural areas.[23] Under this new definition, 17 percent of America lacks broadband access, and 75 percent of those who have broadband access can choose only one provider. Chairman Wheeler has emphasized these statistics when advocating for reclassification, noting that "[w]here there is no choice, markets cannot work. American families need to be able to shop for affordable prices and faster speeds."[24]

In the absence of a finding of competitive markets, Chairman Wheeler's analogy to regulation of wireless service breaks down. *Orloff*'s hands-off approach to wireless rates is explicitly predicated upon the Commission's faith that market forces will deter unjust or unreasonable rates and discrimination. A recent Commission order emphasized that "in the absence of competitive pressures, the default of cost-based regulation should apply."[25] In that proceeding, which invalidated telephone rates for interstate calls by prison inmates, the Commission explained that a cost-based approach "is consistent with Commission practice that typically focuses on the costs of providing the underlying service when ensuring that rates for service are just and reasonable under Section 201(b)." [26]

The Commission's decision to redefine broadband, and the subsequent conclusions Chairman Wheeler has drawn – wrongly, I think – as to broadband competitiveness, may provide useful talking points to support his Title II reclassification plan. But together, the one-two punch of redefining and then reclassifying broadband service will make it difficult to fulfill the Chairman's promises to avoid broadband rate regulation. Title II requires the Commission to assure carrier rates are just, reasonable, and nondiscriminatory. In markets that the Commission claims are uncompetitive, this requires a searching inquiry to determine whether the rates in question are supported by costs – an inquiry that has taken ten years in the relatively simple world of inmate telephone calls and will be immeasurably more complex when applied to broadband networks.

The Commission may forbear from tariffing and unbundling broadband service. But under Title II it will play a significant and active role in determining the nation's broadband rates. To deny this fact is foolish optimism at best, and at worst is deceiving the public as to the inevitable effect of reclassification.

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The Free State Foundation is an independent**,** nonpartisan free market-oriented think tank located in Rockville, Maryland.

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[1] Tom Wheeler, *FCC Chairman Tom Wheeler: This is How We Will Ensure Net Neutrality*, WIRED MAGAZINE, Fe. 4, 2015, available at http://www.wired.com/2015/02/fcc-chairman-wheeler-net-neutrality/.
[2] Federal Communications Commission, *Fact Sheet: Chairman Wheeler Proposes New Rules for Protecting the Open Internet*, available at http://transition.fcc.gov/Daily_Releases/Daily_Business/2015/db0204/DOC-331869A1.pdf.
[3] See, e.g., *In re Developing a Unified Intercarrier Compensation Regime*, 16 FCC RCD. 9610 (2001) (discussing intercarrier compensation under Section 201).
[4] 47 U.S.C. § 201(b) (emphasis added).
[5] *Id.* § 202(a) (emphasis added).
[6] *Id.* § 208 (emphasis added).
[7] See Fact Sheet, supra note 2.
[8] See, e.g., MCI Telecomm. Corp. v. AT&T, 512 U.S. 218 (1994).
[9] See, e.g., Verizon Comm'cns v. FCC, 535 U.s. 467 (2002).
[10] See, e.g., Larry F. Darby, Jeffrey A. Eisenach, and Joseph S. Kraemer, *The CLEC Experiment: Anatomy of a Meltdown*, Progress and Freedom Foundation Progress on Point Paper, Vol. 9, No. 23 (2002).
[11] Orloff v. FCC, 352 F.3d 415 (2003).
[12] *Id.* at 419; *see also id.* at 418 ("As in the Interstate Commerce Act, 'rate filing was Congress's chosen means of preventing unreasonableness and discrimination in charges' by common carriers.") (citing *MCI*, 512 U.S. at 230).
[13] *Id.*
[14] *Id.* at 420.
[15] Orloff v. Vodafone Airtouch Licenses LLC, 17 FCC Rcd. 8987, 8997 (2002).
[16] *Id.* at 8998.
[17] *Id*. at 8988.
[18] *Id.*
[19] *Id.* at 8993.
[20] *Id.* at 8996.
[21] *Orloff*, 352 F.3d at 420, 421 (internal quotation marks and citations omitted).
[22] Federal Communications Commission, *2015 Broadband Progress Report and Notice of Inquiry of Immediate Action to Accelerate Deployment*, No. 14-126, Feb. 4, 2015, at ¶ 3, available at http://transition.fcc.gov/Daily_Releases/Daily_Business/2015/db0206/FCC-15-10A1.pdf.
[23] See Dissenting Statement of Commissioner Ajit Pai, available at http://transition.fcc.gov/Daily_Releases/Daily_Business/2015/db0204/FCC-15-10A6.pdf.
[24] Remarks of FCC Chairman Tom Wheeler, Silicon Flatirons Center, Feb. 9, 2015, available at http://transition.fcc.gov/Daily_Releases/Daily_Business/2015/db0209/DOC-331943A1.pdf.
[25] In re Rates for Interstate Inmate Calling Services, No. 12-375, Oct. 22, 2014, ¶ 9.
[26] *Id.*