Insight

Court Finds Network Neutrality Rules Both Legal And Bad Policy

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In a much-awaited decision, the DC Circuit Court upheld the Federal Communications Commission's (FCC) onerous reclassification of Internet service providers (ISPs) to be common carrier services. The decision is a major victory for the Obama Administration, the FCC, and advocates supporting the net neutrality regulations. Even though the court found the FCC's actions legal, it admitted that the FCC's policy is paradoxical, lacks economic and analytical rigor, and is likely to hurt innovation. For consumers, and for future dynamism in the industry, the ruling signals a rocky road ahead.

The 184-page ruling marks the third time that the agency faced court scrutiny for pushing so-called network neutrality rules because Congress has never explicitly given the FCC such a mandate. The network neutrality rules would implement the following:

- A ban on blocking legal content, applications, services or non-harmful devices,
- A ban on throttling lawful Internet traffic on the basis of content, applications, services, or non-harmful devices,
- A ban on paid prioritization, which would have favored some lawful Internet traffic over others, and
- An adoption of a new and vague General Conduct Rule that would give the FCC power to ban practices not covered in the rules.

As with the 2010 and 2014 court cases, the legal basis for the rules was at issue. For the most recent iteration, the agency rooted the rules by completely reclassifying Internet service. In the 1996 update to the Communications Act, two kinds of services were formalized, information services and telecommunications services. Consumer Internet access was traditionally classified as an information service, which receives light regulatory treatment. Similarly, telephone was regulated under the more restrictive telecommunications services classification, which includes a long list of requirements including rate regulation. In reclassifying Internet service to become a telecommunications service, the FCC shifted it into a regulatory scheme designed for monopoly era telephone.

In 2002, the FCC formally classified cable broadband as an information service and fought a string of lawsuits. The agency won in 2005 at the Supreme Court under a case called *Brand X*. Shortly thereafter, the agency classified DSL as an information service, then put broadband over powerline in the same regulatory bucket, and finally classified wireless broadband under the light regulatory regime in 2007. The agency held to that view until 2010 when it was reeling from its first loss in court over network neutrality rules and asked for comment on reclassifying Internet service, even though it ultimately rejected that move. Indeed, when the FCC put out its third version of the rules in 2014, reclassification wasn't the preferred option. Only after a blitz by the White House did the agency change its tune and fully endorse the more aggressive proposal.

As the court found, the FCC could drastically change course because of an important legal doctrine known as *Chevron* deference. *Chevron* deference grants wide latitude to government agencies in enforcing statutes and

making rules as long as the interpretations are reasonable. With this decision, the FCC has been granted vast power to regulate in this space that only Congress can now curtail.

Most telling is just what isn't at stake in this case. As the decision makes clear,

> "Critically, we do not 'inquire as to whether the agency's decision is wise as a policy matter; indeed, we are forbidden from substituting our judgment for that of the agency.' Nor do we inquire whether 'some or many economists would disapprove of the [agency's] approach' because 'we do not sit as a panel of referees on a professional economics journal, but as a panel of generalist judges obliged to defer to a reasonable judgment by an agency acting pursuant to congressionally delegated authority.'"

Indeed, Judge Williams' minority opinion in the case largely accepted the majority's decision on the legalities of reclassification but lambasted the agency for the rules' local inconsistencies and economic shortcomings. For one, the 1996 Telecommunications Act was written to "promote competition and reduce regulation in order to secure lower prices and higher quality services for American telecommunications consumers and encourage the rapid deployment of new telecommunications technologies." But in pushing these rules, the agency was clearly increasing regulation without any consideration of competition. In the Commission's own words, "These rules do not address, and are not designed to deal with, the acquisition or maintenance of market power or its abuse, real or potential." In addition, the FCC admitted that vague rules threaten to stymie innovation, but then they proceeded to adopt vague rules with the General Conduct Standard, which the FCC Chairman readily admitted left questions about what conduct is actually proscribed. Moreover, the agency gave the silent treatment to three of its former chief economists, interpreted studies in such a way as to receive formal rebukes from authors, tacitly admitted that the rules will "cement the advantages" of incumbents, and agreed that it had no experience with paid prioritization but then banned it anyway.

What's next? For the network neutrality rules, there are two more stops. The ruling could be petitioned for an *en banc* hearing, where the entire Circuit, not just the three judge panel, would review the case. However, *en banc* reviews are rare, so it will probably come down to the Supreme Court. Yet, the last time the Supreme Court decided on this kind of case, in *Brand X*, only Justices Scalia, Ginsberg and Souter said that the FCC's classification was unreasonable. The majority deferred to the agency's interpretation using *Chevron* and would likely do so again. Barring some massive change in the court, it is unclear that the case would even make it up to the highest court, so this decision is likely to stand.

Immediately, a range of potentially innovative services are made illegal, including Verizon's rumored branded NFL phone. Other data plans, including those that have been helpful for low income consumers, will be placed under intense scrutiny. Entrants to the broadband market will face higher costs, and smaller broadband players will be squeezed. For the agency, this ruling will also be used to further broadband privacy rules, which is similarly bad policy, as AAF has explained. In total, this decision marks the end of permissionless innovation in the broadband space and the beginning of FCC adventurism. Only a Congressional rewrite of the Communication Act that focuses on competition, relies on rigorous analysis, and seeks remedies when there is proven harm, will set the FCC back on track. Let's hope the agency doesn't do any more damage in the meantime.