

► **Advisory Report**

The FCC Eliminates DSL Internet Sharing, Handing RBOCs Freedom over Broadband Resale

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■ Summary

Issue

On August 5, the Federal Communications Commission (FCC) removed requirements that incumbent local carriers must provide DSL broadband access to third-party Internet service providers (ISPs) under the same terms and conditions as their own ISP. The FCC used the Supreme Court decision in the NCTA v. Brand X case as precedent that consumer broadband Internet is classified as an “information service,” not a “telecommunications service,” and is therefore exempt from common carrier requirements (see “Its Business as Usual for Cable Industry as Supreme Court Denies Brand X Access Bid,” July 8, 2005). The changing regulations give third-party ISPs selling DSL one year of grandfathered service, during which they can work on negotiating market-based rates with incumbent local carriers.

Analytical Summary

With its latest DSL order, the FCC continues its consistent track record, set during the Michael Powell years, of dismantling regulations controlling local telecommunications competition in favor of letting the market decide. Citing changing technology and market conditions, the order bypasses three decades of common carrier regulation. The surface FCC justifications are skimpy, such as blaming broadband ISP resale for delays in telcos developing and deploying innovations. Some Commissioners' individual statements suggest that the Supreme Court NCTA v. Brand X decision simply forced their hand. In practical terms, the ruling does not change the topology of the residential broadband market much, because third-party ISP resale of incumbent local carrier DSL could not compete on price. However, the ruling's somewhat bizarre underlying logic could pressure the FCC to re-classify additional common carrier services as information services.

■ Perspective

Current Perspective

On August 5, the Federal Communications Commission (FCC) removed requirements that the regional Bell operating companies (RBOCs) must provide DSL broadband access to third-party Internet service providers (ISPs) under the same terms and conditions as their own ISP. The FCC used the Supreme Court decision in the NCTA v. Brand X case as precedent that consumer broadband Internet is classified as an “information service,” not a “telecommunications service,” and is therefore exempt from common carrier requirements (see “It's Business as Usual for Cable Industry as Supreme Court Denies Brand X Access Bid,” July 8, 2005). The changing regulations give third-party ISPs selling DSL one year of grandfathered service, during which they can work on negotiating market-based rates with incumbent local carriers.

Report:

**The FCC Eliminates
DSL Internet
Sharing, Handing
RBOCs Freedom over
Broadband Resale**

The FCC order carries implications on many fronts. Least significant is the practical, near-term direct impact on end customers. Carriers that provide their own DSL infrastructure (such as Covad Communications, New Edge Networks, and a number of other CLECs) and those that resell CLEC-provided DSL services (a lengthy list, including AT&T, MCI, Earthlink, and Speakeasy) are unaffected by the order. Earthlink is the only top-tier consumer ISP greatly affected, since the carrier resells a mix of Covad and RBOC DSL, as well as reselling cable TV broadband. The largest consumer ISPs, America Online (AOL) and Microsoft Network (MSN), got out of the DSL resale market back in 2003, choosing to focus on a higher-margin “bring your own access” strategy of reselling standalone content and applications. A vast number of small ISPs will also be affected to some extent. Qwest, for example, shows a list of hundreds of ISPs using its DSL service, from Abba Communications to Zipcon. However, with residential DSL straight from RBOCs starting as low as \$19.95-\$26.95 a month with SBC and \$29.95 a month with Verizon, even a large competitor such as Earthlink is outpriced at its standard DSL rate of \$39.95 a month and must focus its marketing message on delivering premium customer value.

The business considerations are more troubling. The FCC has previously ceased requirements for the RBOCs to un-bundle DSL from voice access lines (see “Covad Reaches Line Splitting Agreements with MCI and VarTec,” Sept. 3, 2003). The Commission phased out wholesale rate regulation of RBOC-provided dial tone (see “Life after UNE-P: What Can CLECs Do Once Unbundled Switch Rate Regulation Goes Away?,” June 15, 2004). In 2004, the FCC also gave the RBOCs regulatory exemptions to open access requirements on next-generation residential fiber builds, including fiber builds to multi-dwelling units (MDUs), as long as the primary purpose of these builds is residential services. Each FCC ruling may have its own, separate logic. However, taken together, the DSL order looks like a disincentive for the Bells to build out residential fiber. Residential fiber was positioned as a way for the RBOCs to get an exemption from common carrier requirements; however, DSL Internet is now re-classified as an information service and is no longer subject to common carrier requirements either.

The technology aspect behind the Supreme Court Brand X decision, and the subsequent FCC classifying of DSL Internet as an information service, is where matters could get bizarre. If Internet service is inseparable from its DSL capacity pipes, the line between what is “open” and what is “closed” is one of modulation techniques. RBOC-provided dedicated Internet access using synchronous DSL (SDSL) or IDSL (ISDN DSL) would appear exempt from regulation, while HDSL-delivered T1 is both a traditional FCC-defined “high-capacity service” and DSL. Likewise, it is not clear yet whether RBOCs still need to provide DSL on a common carrier basis in any form, for example, to third-parties that do not plan to offer Internet access, but instead want to buy RBOC DSL to connect private business networks.

Last year's UNE-P phase-out suggests that the RBOCs will not take any extreme stance to try to destroy resellers; they will be accommodating to DSL broadband resellers when it comes time to negotiate market-based rates. There is another reason why ISP DSL resellers are likely to be better off than UNE-P resellers before them; unlike the UNE-P landscape, the incumbents have not been griping loudly about losing money on DSL resale rates that are set artificially low. Nevertheless, individual ISPs' experiences in negotiating with the RBOCs will vary, and the RBOCs do now have the right to lock out third-party ISPs from reselling their DSL Internet services.

To sum up, the FCC's decision to deregulate DSL should not have a large market impact on residential and small business customers for the near to mid-term. From a logical perspective, the Supreme Court's NCTA v. Brand X decision is a weak foundation on which to base a

Report:

**The FCC Eliminates
DSL Internet
Sharing, Handing
RBOCs Freedom over
Broadband Resale**

decision to re-classify the DSL portion of an Internet service from a common carrier service to part of an information service. However, the order makes sense if seen from the perspective of Commissioners that chose to rule proactively, before the RBOCs took their grievances to the courts and forced changes on the Commission.

Recommended Actions

Vendor Actions

- Larger third-party ISPs reselling DSL from the RBOCs ought to be safe for the foreseeable future, at least where their existing customer bases are concerned. For larger ISPs, the RBOCs will probably want to exemplify their good behavior, will implement only modest increases, and will not turn third-party ISPs away even after they are no longer required to keep DSL services open.
- Very small ISPs may face hardship in getting access to broadband after deregulation, but not because the RBOCs would close their DSL networks or raise rates prohibitively. Instead, the application and approval process may become more complicated and resource-intensive; it may become more work than a tiny ISP could easily manage.
- Some CLECs specializing in serving residential and small business customers may not be willing to resell service under the thumb of RBOCs unfettered from regulatory constraints. These CLECs have two options: partner with other CLECs deployed in telco central offices, or deploy their own collocated gear.
- Concerns voiced that third-party Internet content and applications providers, including dial tone VoIP, will be blocked by the RBOCs once DSL no longer holds common carrier status are highly unlikely. Never mind that the FCC is looking into building Internet consumer protections. If carriers begin to meddle in the content they deliver to customers, it opens the door to the carrier policing content – and being potentially liable for the content it does deliver.

User Actions

- The great majority of broadband customers use DSL supplied directly through an RBOC, DSL provided through a CLEC's infrastructure, or cable-based broadband. None of these DSL Internet services will be affected by the FCC's order, so consumers in most locations still have the choice between cable broadband from their cable provider and DSL broadband from a telephone company.
- Consumers purchasing DSL through Earthlink, or one of many smaller ISPs, should not be greatly affected in the near future. It is not unusual for ISPs to resell broadband services from more than one source. Earthlink, for example, resells consumer broadband from sources including the RBOCs, Covad, and Time Warner Cable. Broadband rates for some customers served by one of these ISPs may rise modestly over the next year, but major price hikes should not happen.
- Some small ISPs may choose to pull the plug on new broadband sales in light of the FCC order. The most vulnerable would be ISPs that already cannot justify the effort they put into working with their local telco to sell broadband service; even a modest wholesale price increase, or additional hurdles in putting together a negotiated contract with the telco, may be enough to push a small ISP out of broadband resale.
- Resellers of complex business services that rely on DSL, such as New Edge Networks' BigFoot

Report:

**The FCC Eliminates
DSL Internet
Sharing, Handing
RBOCs Freedom over
Broadband Resale**

services or managed services by MegaPath and many others, may be most greatly affected by the FCC order. The FCC order redefines DSL with Internet as an information service without common carrier restrictions. The language suggests it is not just limited to consumers and that sophisticated business services resellers will also need to come to the negotiating table with the RBOCs, which could significantly raise their operating costs, and therefore raise the rates they pass on to enterprise clients.