OFFICE OF ADVOCACY
U.S. SMALL BUSINESS ADMINISTRATION
WASHINGTON, DC 20416

August 27, 2002

Honorable Michael K. Powell
Chairman
Federal Communications Commission
445 12th Street, S.W.
Room 8-B201
Washington, DC 20554

RE: Ex Parte Presentation in a Non-Restricted Proceeding
Initial Regulatory Flexibility Analysis for Appropriate Framework for Broadband Access to the Internet over Wireline Facilities (CC Dkt. No. 02-33)

Dear Mr. Chairman:

As part of its statutory duty to monitor and report on an agency's compliance with the Regulatory Flexibility Act of 1980 ("RFA"), as amended by the Small Business Regulatory Enforcement Fairness Act of 1996 ("SBREFA"),[1] the Office of Advocacy of the U.S. Small Business Administration ("Advocacy"), has reviewed the Federal Communications Commission's ("FCC" or "Commission") compliance with the RFA's requirements for the Notice of Proposed Rulemaking ("NPRM") in the above-captioned proceeding.[2]

In the NPRM, the Commission seeks to classify the provision of wireline broadband Internet access service and identify the ramifications of such classification.[3] The Commission tentatively concludes that wireline broadband Internet access service is an information service.[4] While the Commission conducted an Initial Regulatory Flexibility Analysis ("IRFA"), the Commission did not analyze the impact of this classification on small Internet Service Providers ("ISPs"). According to commenters, classifying broadband Internet access as an information service would affect more than 7,000 small businesses and could cost those businesses an estimated $8 billion in revenue.

To comply with the RFA, Advocacy recommends that the Commission revise its IRFA to include an analysis of what impact that classification of wireline broadband Internet access service would have on small ISPs. If the Commission declines to take this step, we encourage

---

[1] Pub. L. No. 96-354, 94 Stat. 1164 (1980) (codified at 5 U.S.C. § 601 et seq.) amended by Subtitle II of the Contract with America Advancement Act, Pub. L. No. 104-121, 110 Stat. 857 (1996). 5 U.S.C. § 612(a).
[2] *In the Matter of* Implementation of Subscriber Carrier Selection Changes Provisions of the Telecommunications Act of 1996 and Policies and Rules Concerning Unauthorized Changes of Consumers Long Distance Carriers, *Third Report and Order and Second Order on Reconsideration*, CC Dkt. No. 94-129, FCC 00-255 (rel. Aug. 15, 2000).
[3] NPRM at para. 9.
[4] *Id*. at para. 17.

the Commission to address the impact in the Final Regulatory Flexibility Analysis ("FRFA") when it adopts the final rule.

Furthermore, Advocacy urges the Commission to adopt the alternative proposed by commenters and classify wireline broadband Internet access service as composed of two separate services – the transmission of broadband signals as a telecommunications service, and the the provision of Internet access service as an information service. This alternative will accomplish the Commission's regulatory goal of encouraging broadband deployment, while minimizing the disproportionate impact on small businesses.

1. Advocacy Background.

Congress established the Office of Advocacy in 1976 by Pub. L. No. 94-305[5] to represent the views and interests of small business within the Federal government. Advocacy's statutory duties include serving as a focal point for the receipt of complaints concerning the government's policies as they affect small business, developing proposals for changes in Federal agencies' policies, and communicating these proposals to the agencies.[6] Advocacy also has a statutory duty to monitor and report to Congress on the Commission's compliance with the RFA.

The RFA was designed to ensure that, while accomplishing their intended purposes, regulations did not unduly inhibit the ability of small entities to compete, innovate, or to comply with the regulation.[7] The major objectives of the RFA are: (1) to increase agency awareness and understanding of the potential disproportionate impact of regulations on small business; (2) to require that agencies communicate and explain their findings to the public and make these explanations transparent; and (3) to encourage agencies to use flexibility and provide regulatory relief to small entities where feasible and appropriate to its public policy objectives.[8] The RFA does not seek preferential treatment for small businesses. Rather, it establishes an analytical requirement for determining how public issues can best be resolved without erecting barriers to competition. To this end, the RFA requires the agencies to analyze the economic impact of proposed regulations on different-sized entities, estimate each rule's effectiveness in addressing the agency's purpose for the rule, and consider alternatives that will achieve the rule's objectives while minimizing any disproportionate burden on small entities.[9]

On August 14, 2002, President George W. Bush signed Executive Order 13272 that requires federal agencies to implement policies protecting small businesses when writing new rules and regulations.[10] This Executive Order authorizes Advocacy to provide comment on draft rules to the agency that has proposed or intends to propose the rules and to the Office of Information and

[5] Pub. L. No. 94-305 (codified as amended at 15 U.S.C. §§ 634 a-g, 637).
[6] 15 U.S.C. § 634(c)(1)-(4).
[7] 5 U.S.C. § 601(4)-(5).
[8] *See generally*, Office of Advocacy, U.S. Small Business Administration, *The Regulatory Flexibility Act: An Implementation Guide for Federal Agencies*, 1998 ("*Advocacy 1998 RFA Implementation Guide*").
[9] 5 U.S.C. § 604.
[10] Exec. Order. No. 13272 § 1, 67 Fed. Reg. 53,461 (2002).

Regulatory Affairs of the Office of Management and Budget.[11] It also requires agencies to give every appropriate consideration to any comments provided by Advocacy regarding a draft rule. The agency shall include, in any explanation or discussion accompanying publication in the *Federal Register* of a final rule, the agency's response to any written comments submitted by Advocacy on the proposed rule, unless the agency certifies that the public interest is not served by doing so.[12]

2. Defining Wireline Broadband Internet Access Services as Information Services Will Heavily Burden Small ISPs.

After reviewing the Commission's proposed rule, the IRFA and comments, Advocacy is concerned the Commission has understated the impact on small ISPs of its tentative conclusion classifying broadband access service as an information service. Classifying broadband access service as an information service would remove the requirements set forth in the Commission's Computer II[13] and Computer III[14] rulemakings that provide carriage to ISPs.[15] Such an action will severely hamper the ability of small ISPs to provide broadband service, stifling competition and slowing down deployment. Although Advocacy shares the Commission's commitment to deregulation to bolster competition and spur economic growth, in this instance, complete deregulation will create impenetrable barriers to entry, eliminating competition from small businesses and removing consumer choice.

a. Small ISPs Provide a Substantial Number of Competitors and Bring Competition to Rural Areas.

In the IRFA, using 1997 data, the Commission identifies small ISPs as an affected class of entities and estimates there are between 2,829 to 2,940 small ISPs.[16] One commenter noted that industry sources estimate the number of ISPs at more than 7,200.[17] The latest numbers available to Advocacy support this claim. Based on 1999 North American Industry Classification System ("NAICS") data broken down by firm size,[18] there are a total of 7,099 ISP firms, of which 6,975 have less than 500 employees.[19] While this number is based on data that is three years old in a

[11] *Id*. at § 2(c).
[12] *Id*. at § 3(c).
[13] Amendment of Section 64.702 of the Commissions Rules and Regulations, 77 FCC 2d 384 (1980)("Computer II").
[14] *Amendment of the Section 64.702 of the Commission's Rules and Regulations (Computer III Phase I Order*), 104 FCC 2d 958 (1986) ("Computer III").
[15] NPRM at paras. 42-44.
[16] *Id*. at para 98.
[17] Comments of TeleTruth to the *Notice of Proposed Rulemaking* in CC Dkt. No. 02-33, p. 34, (May 3, 2002) ("TeleTruth Comments").
[18] NAICS #514191 (Online Information Services).
[19] "Employer Firms and Employment by Employment Size of Firm by NAICS (1999) (last visited August 19, 2002) <http://www.sba.gov/advo/stats/us99_n6.pdf>. The SBA defines small "Online Information Services" as those businesses having $18 million or less in revenue in a year. The U.S. Census data is listed by number of employees. The only data based on revenue dates back to 1997, which will not capture the growth during the technological boom of the late 1990s. Therefore, we are utilizing the most recent data (1999) which is broken down by employment size.

rapidly changing industry, it supports the commenters' assertion that there are approximately 7,000 small ISPs.

Small ISPs have a substantial share of the Internet service market and are crucial to competition. Together, small ISPs serve 77 million customers, which represent 55 percent of the market.[20] In addition, small ISPs have been instrumental in bringing service to rural areas where costs are high and returns on investment low.[21]

b. Small ISPs Are Disproportionately Burdened by the Proposed Rule.

Out of all the entities identified as affected classes in the IRFA, small ISPs are the most significantly affected. Small ISPs, which constitute the majority of ISPs nationally, are dependent upon transport over wireline carriers' facilities. An overwhelming number of ISPs have access arrangements with wireline carriers rather than cable providers,[22] and 93 percent of all digital subscriber lines are provided by incumbent local carriers.[23] As an ISP organization noted, a small ISP's options other than carriage on a wireline carrier's lines are virtually non-existent.[24] Therefore, small ISPs are dependent on the incumbent wireline carriers to carry their signals.[25] Even for small ISPs dealing mainly with the provision of broadband, the total reliance upon carriage over wireline carriers' facilities is undisputed.

This dependence is born from 80 years of government-sanctioned monopoly that enabled incumbent wireline carriers to construct a pervasive network to almost every home and business in the nation. Such a network will take decades to replicate, if it is possible to replicate at all, considering changes in the regulatory environment and the reluctance of local communities to installing new wires. The "last mile" of the network, which extends from a home or business to the central office of the incumbent wireline carrier, is particularly difficult for small alternative carriers to replicate or bypass, which grants the incumbent carrier a near monopoly in residential areas and a substantial economic advantage in business districts.

In the NPRM, the Commission appears to operate under the assumption that broadband is a completely separate service from voice telephone. Several commenters question this assumption, and claim that broadband is an extension of existing wireline telephony systems. One commenter states that no separate broadband network exists. Instead, wireline carriers are using the same copper structure that is used to carry voice telephony.[26] Another commenter

[20] TeleTruth Comments at 35.
[21] *Id*. at 45; Comments of TDS, Telecommunications Corporation, Madison River Communications, and North Pittsburgh Systems, Inc. to the *Notice of Proposed Rulemaking* in CC Dkt. No. 02-33, at 15, (May 3, 2002) ("TDS Comments").
[22] Reply Comments of the High Tech Broadband Coalition to the *Notice of Proposed Rulemaking* in CC Dkt. No. 02-33, at 7 (May 3, 2002) ("HTBC Reply Comments").
[23] Reply Comments of the Ad Hoc Telecommunications Users Committee to the *Notice of Proposed Rulemaking* in CC Dkt. No. 02-33, at 17 (May 3, 2002) ("Ad Hoc Reply Comments").
[24] Reply Comments of California Internet Service Providers Assoc. to the *Notice of Proposed Rulemaking* in CC Dkt. No. 02-33, at 23 (May 3, 2002) ("Calif. ISPA Reply Comments").
[25] TeleTruth Comments at 43.
[26] TDS Comments at 10.

states that the voice telephony market and the broadband market are inextricably joined and that recent broadband investments are just on-going upgrades to existing networks.[27] There is merit to both of these comments because wireline broadband is currently using last-mile physical structure. Small ISPs do not have an alternative when it comes to reaching their wireline broadband customers; they rely upon carriage over wireline carriers facilities, as detailed in Computer II and Computer III. If the Commission removes the requirements for local carriers to carry the broadband traffic of small ISPs, incumbent wireline carriers have significant economic reasons to stop doing so. Without that carriage, small ISPs will face a harsh economic future, as Internet service migrates from dial-up to broadband.

Without the carriage requirement of Computer II and Computer III, control over the last mile gives wireline carriers an enormous bargaining advantage when dealing with ISPs, and the potential for discrimination by wireline carriers is a real concern. Small ISPs have no leverage and no alternatives but to take whatever deal is offered to them by the wireline carriers. As commenters noted, the potential for discrimination by the wireline carriers in the absence of the Computer II and Computer III safeguards is real,[28] and a different regulatory treatment for broadband would encourage wireline carriers to close their networks or engage in anti-competitive and supra-competitive pricing.[29]

If the incumbent wireline carriers refuse to provide broadband access services to small ISPs, one commenter estimates the cost to small ISPs at $8 billion in lost revenue.[30] Such a blow would cripple the ISP industry and force hundreds of small businesses into bankruptcy, further endangering the prospect of sound economic recovery. Furthermore, competition would be thwarted, as these small ISPs and other alternative providers are driven out of the marketplace.[31] Should small ISPs cease operating, the Internet access market will be controlled by a duopoly – a wireline carrier monopolist that dominates in the provision of Internet services to businesses, and the cable monopolist that dominates in the provision of Internet services to residences.

c. Commission Should Analyze Impact of Reclassification on Small ISPs in a Revised IRFA and in the FRFA.

The IRFA did not address these issues described above nor analyze what the impact will be on 7,000 small ISPs. The Commission is proposing changes to the regulatory foundation for an entire industry, which will have a sweeping and dramatic impact on all small ISPs. The Office of Advocacy recommends that the Commission revise its IRFA to include an analysis of the impact that classifying wireline broadband Internet access service as an information service would have on small ISPs.

[27] Calif. ISPA Reply Comments at 29.
[28] Calif. ISPA Reply Comments at 16; HTBC Reply Comments at i.
[29] TDS Comments at 12; Ad Hoc Reply Comments at ii.
[30] TeleTruth Comments at 46.
[31] TDS Comments at 2.

If the FCC does not take the step of issuing a revised IRFA, Advocacy urges the Commission to analyze the issues raised by commenters in a FRFA when the final rule is adopted[32] and describe the steps that the agency has taken to minimize the costs on small businesses.[33] Specifically, the Commission should address the issues discussed above and explain what steps the FCC has taken to minimize the impact of a rule that could remove 7,000 small businesses from the broadband marketplace. If the Commission adopts the rule as proposed, it should explain how the rule serves the public interest, defined by the Commission in the NPRM as encouraging competition and broadband deployment, by removing small business from the marketplace.

3. Commission Should Consider Alternatives Less Burdensome to Small Businesses.

The RFA requires carriers to propose alternatives in the IRFA and to consider alternatives proposed by commenters in the FRFA.[34] After reviewing the comments, Advocacy recommends that the Commission consider and adopt the alternative proposed by commenters to encourage deployment of broadband by facilitating competition. The Commission can do this by classifying the transmission portion of broadband Internet service as a telecommunications service while the Internet service should be classified as an information service.

a. Facilitating Competition Will Encourage the Deployment of Broadband.

As stated by commenters, competition drives innovation, and it is competition that will drive the deployment of broadband.[35] This has been borne out time and again in the telecommunications field. Long distance service was revolutionized by the advent of competition. The costs of wireless telecommunications dropped and a myriad of services proliferated as more competitors entered the field. In the Internet field, it was the competitive forces of thousands of ISPs, many of them small, who brought the World Wide Web and e-mail to consumers. Many parts of rural America would still be without Internet access but for competitive forces that forced small ISPs to find niche markets.

When there is a lack of competition, innovation stagnates, and so will the deployment of broadband. One commenter noted that wireline carriers delayed introduction of broadband until competition forced them to enter the market,[36] while another states that carriers will always choose to deploy broadband in areas where there is competition first.[37] Another commenter states that maintining the diversity of ISPs is the best way to ensure that there are broadband choices, as small ISPs will cater to the needs of niche broadband consumers, which will encourage deployment.[38]

---

[32] 5 U.S.C. §. 604(a)(2).
[33] *Id*. at § 604(a)(5).
[34] 5 U.S.C. § 603(c); 5 U.S.C. § 604 (a)(5).
[35] TDS Comments at 7; Comments of AOL Time Warner, Inc. to the *Notice of Proposed Rulemaking* in CC Dkt. No. 02-33, at 23 (May 3, 2002) ("AOL Comments").
[36] Calif. ISPA Reply Comments at 7.
[37] TDS Comments at 7.
[38] AOL Comments at 23.

To maximize broadband deployment, there must be competition within the type of carriages as well as between types of transport. The Commission should not rely upon cable as the sole source of competition to wireline broadband, because cable is not a perfect substitute for wireline broadband. The physical plants do not generally overlap; cable dominates the residential broadband market, while wireline carriers dominate the business market and have a presence in every single home in the United States.[39]

If the incumbent wireline carrier is the sole source for wireline broadband communications, large numbers of small business consumers will have a single choice for broadband Internet service and will likely face higher rates, more restricted service, and delays on deployment of broadband service. Because of the incentive structure faced by the incumbent wireline carrier, rural consumers, and consumers in low-density areas would have little chance of receiving broadband services. Deployment, then, becomes a classic case of "cherry picking" and is not consistent with the Commission's goals.

b. Broadband Internet Service Should Be Classified as Two Distinct Services.

Consistent with comments received by the FCC, Advocacy recommends that the Commission revisit its conclusion that broadband Internet access service is an information service.[40] In fact, we urge the Commission to classify the transmission of broadband signals as a telecommunications service, and the provision of Internet access service as an information service, as originally determined in Computer II and Computer III. By deciding that broadband Internet service consists of two distinct services, the Commission will minimize the disproportionate impact on small ISPs and will encourage competition in the broadband market, which will in turn encourage deployment of broadband as discussed above.

Computer II and Computer III created a regulatory environment that allowed a new sector of business to grow and thrive. In those two rulemakings, the Commission declared that the provision of Internet service was an information service and that incumbent wireline carriers were required to provide carriage of signals to and from ISPs.[41] This allowed the ISP industry to blossom and thrive, because it did not burden them with unnecessary regulations, while at the same time allowing them to interconnect with the telephone network and access customers. If the carriage requirement was not there, it is unlikely that ISPs would have been able to interconnect and reach their customers. As one commenter warned, premature elimination of Computer II and Computer III carriage requirements will diminish the competition that currently exists.[42]

[39] Calif. ISPA Reply Comments at 25-6; Ad Hoc Reply Comments at 7.
[40] New York Dept. of Public Service, p. 3 Comments of New York State Dept. of Public Service to the *Notice of Proposed Rulemaking* in CC Dkt. No. 02-33, at 3 (May 3, 2002); TDS Comments at 14; AOL Comments at 3.
[41] *See* Computer II and Computer III, *supra* notes 13 and 14.
[42] Ad Hoc Reply Comments at 9.

In addition, if the Commission finds that broadband Internet access is an information service, it raises the specter of regulatory gaming[43] by incumbent wireline carriers. Broadband networks do not distinguish between data or voice, and wireline carriers will have enormous incentive to avoid regulation by transmitting voice communications as broadband transmissions. This regulatory gaming would undermine many of the FCC's public interest goals, such as local competition and Universal Service. By categorizing the transmission component of broadband Internet service as a telecommunications service, the FCC can minimize regulatory gaming and promote greater competition.[44]

c. Swift and Proper Enforcement of Current Rules Will Encourage Broadband Deployment.

Several commenters raised the alternative that the Commission more stringently enforce the rules requiring carriage of Internet signals.[45] Because small ISPs are completely dependent upon wireline carriers to carry their signals due to difficulties in circumventing the last mile, these carriers have a tremendous economic advantage. Advocacy agrees with these commenters and recommends that the Commission consider alternatives proposed by the commenters. In order to ensure that competition thrives and the wireline carrier does not leverage its position, the Commission should mandate availability of broadband unbundled network elements and enforce its unbundling requirements.[46] In addition, the Commission should ensure that ISPs are afforded just, reasonable, and non-discriminatory access to wireline transmission services as required by Computer II and Computer III.[47] Finally, the Commission should consider establishing an enforcement process for resolving ISP-related issues.[48]

4. Conclusion.

Deployment of broadband is squarely in the public interest. Broadband holds the promise of technological innovation, better communications, and bridging vast distances within our nation. Congress has recognized this and has mandated that the Commission should do all in its power to encourage broadband deployment.

Regrettably, the rapid and universal deployment of broadband has been elusive. The recent economic slowdown in the technology sector has frustrated efforts to deploy service. In addition, the Internet has not yet reached the point where consumer demand for broadband drives deployment as rapidly and as universally as lawmakers and regulators would hope. It is coming, but it is coming slowly.

---

[43] Regulatory gaming is defined as using regulations in a manner in which they were not intended to gain a competitive advantage.
[44] TDS Comments at 14.
[45] TDS Comments at 8; HTBC Reply Comments at 12; AOL Comments at 21.
[46] TDS Comments at 8.
[47] AOL Comments at 14.
[48] *Id*. at 31.

When crafting regulation to encourage broadband deployment, the Commission should not overlook the impact that its actions will have on small businesses, particularly the thousands of small ISPs. The small ISPs have played a crucial role in bringing the Internet to the American public and are poised to play an equally crucial role in the deployment of broadband. The proposed rule's IRFA did not analyze the severe and disproportionate impact on small ISPs that classifying wireline broadband Internet access service as an information service would have. Advocacy urges the Commission to revise its IRFA to include an analysis of this impact.

If the Commission declines to take this step, we encourage the Commission to analyze the issues raised by commenters in a FRFA. In particular, the Commission should consider the alternatives proposed by commenters. Advocacy particularly recommends that the Commission adopt the alternative proposed by commenters that would classify wireline broadband Internet access service as composed of two separate services – the transmission of broadband signals as a telecommunications service, while the provision of Internet access service as an information service. This alternative will accomplish the Commission's regulatory goal of encouraging broadband deployment, while minimizing the disproportionate impact on small businesses.

Thank you for your consideration of these matters, and please do not hesitate to contact me or Eric Menge of my staff at (202) 205-6933 or eric.menge@sba.gov if you have questions, comments, or concerns.

Sincerely,

/s/ _____
Thomas M. Sullivan
Chief Counsel for Advocacy

/s/ _____
Eric E. Menge
Assistant Chief Counsel for
Telecommunications

/s/ _____
Radwan Saade, Ph. D.
Regulatory Economist

cc:
Commissioner Kathleen Q. Abernathy
Commissioner Michael J. Copps
Commissioner Kevin J. Martin
William Maher, Chief, Wireline Competition Bureau
Carolyn Fleming Williams, Director, Office of Communications Business Opportunities
John D. Graham, Administrator, Office of Information and Regulatory Affairs, Office of Management and Budget.