

THE BREWING CONTROVERSY OVER INTERNET SERVICE PROVIDERS AND THE UNIVERSAL SERVICE FUND: A THIRD GENERATION INTERPRETATION OF SECTION 254

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I. INTRODUCTION

For years, universal service has meant affordable telephone service for all United States residences, regardless of geographic location.¹ This goal was achieved through a series of subsidization mechanisms imposed upon telephone companies by state and federal regulators.² In a recent ruling, the Federal Communications Commission, in conjunction with a federal-state joint board, developed a variation on traditional universal service concepts: because the Internet has become such an extraordinary modern tool, all schools, libraries and rural health care providers should have access to the Internet at subsidized rates.³ On the surface, the plan appears

quite simple. Internet service providers ("ISPs") will offer Internet access to schools, libraries and rural health care providers at prices well below retail.⁴ The ISPs will be compensated for these discounts through a universal service fund ("USF").⁵ The USF, in turn, will be supported by telecommunications carriers such as long distance phone companies.⁶

However, some of the major telecommunications carriers believe they have a better idea.⁷ Alternatively, they argue that providers of enhanced services, such as ISPs, should not be supported by the universal service fund, despite the FCC's good intentions.⁸ Instead, they assert that ISPs, because they compete to some extent with traditional tele-

¹ Telephone penetration in the United States has been a phenomenal success story with overall penetration at 94 percent. See Monitoring Report, CC Dkt. No. 87-339, at 14 (rel. May 1997); see also Nichole L. Millard, *Universal Service, Section 254 of the Telecommunications Act of 1996: A Hidden Tax?*, 50 FED. COMM. L.J. 255, 256 (1997).

² See Livia Slonage West, *Deregulating Telecommunications: The Conflict Between Competition and Universal Service*, 9 DEPAUL BUS. L.J. 159, 167 (1996) (explaining that the FCC brought local telephone rates to a reasonable level by implementing a complex system of subsidy flows in which long distance rates subsidized local rates, business rates subsidized residential rates, and urban rates subsidized rural rates).

³ The Commission found that all eligible schools and libraries should receive discounts of between twenty percent and ninety percent below retail on all telecommunications services, Internet access, and internal connections provided by telecommunications carriers, subject to a \$2.25 billion annual cap. See *In re Federal-State Joint Board on Universal Service, Report and Order*, 12 FCC Rcd. 8776, 9002 para. 425 (1997) [hereinafter *Universal Service Order*].

⁴ See *id.*; see also Barbara Ford, *Internet: Access for All*, WASH. POST, Jan. 9, 1998, at A20 (extolling the virtues of universal service).

⁵ See *Universal Service Order*, 12 FCC Rcd. at 9002 para. 425, 9015 para. 449. The federal Universal Service Fund for schools and libraries was designed to bring these institutions advanced telecommunications services, such as access to the Internet. See Mike Mills, *D.C. Schools Seek Internet Funding*,

WASH. POST, Mar. 21, 1998, at D1. Subject to a \$2.25 billion cap, schools and libraries nationwide can purchase subsidized telecommunications services and inside wiring from 10 percent to 90 percent of the actual cost. See *id.* The degree of the discount depends upon how many children participate in the federal school lunch program. See *id.* The USF is paid for by telecommunications carriers, primarily long distance providers, and administered by the Schools and Libraries Corp., established by the FCC. See *id.* But see, John Simmons, *Internet-Hookup Group Draws Political Fire*, Wall St. J., Mar. 20, 1998, at A16. The General Accounting Office recently concluded that the FCC exceeded its authority in establishing the Schools and Libraries Corp. See *id.* Senator John McCain plans to hold hearings to consider terminating the new quasiprivate corporation. See *id.*

⁶ "All providers of telecommunications services should make an equitable and nondiscriminatory contribution to the preservation and advancement of universal service." The Telecommunications Act of 1996, Pub. L. No. 104-104, 110 Stat. 56 (codified at 47 U.S.C. § 254(b)(4) (Supp. 1997)).

⁷ See Reply Comments of AT&T Corp., *In re Federal-State Joint Board on Universal Service* (Report to Congress), CC Dkt. No. 96-45, at 9 (Feb. 6, 1998) [hereinafter *AT&T Reply Comments*]; see also Comments of Airtouch Communications, Inc., *In re Federal-State Joint Board on Universal Service* (Report to Congress), CC Dkt. No. 96-45 (Jan. 26, 1998) [hereinafter *Airtouch Comments*] (arguing that the universal service fund should be supported through general tax revenues).

⁸ See Comments of SBC Communications Inc., *In re Fed-*

communications carriers, should have to make contributions to the universal service fund.⁹

To many traditional telecommunications carriers, the idea of subsidizing ISPs is not particularly appealing.¹⁰ They contend that it violates the pro-competitive precepts of the 1996 Act ("1996 Act") to force one group of market players to support another.¹¹ They argue that the relevant provisions of the 1996 Act do not give the FCC carte blanche to play regulatory Robin Hood with their universal service contributions.¹² After all, ISPs offer a telecommunications-like service that could pose serious competition to traditional telecommunications providers in the near future.¹³ In fairness, shouldn't they too have to bear the burden of universal service.¹⁴

At the center of this debate is Section 254 of the Telecommunications Act of 1996.¹⁵ Congress directly addressed the goals of universal service for the first time in the 1996 Act.¹⁶ What was merely

implicit in the Communications Act of 1934 ("1934 Act"),¹⁷ is now laid out in the form of general framework through which the FCC and state regulatory commissions are to achieve the goals of universal service.¹⁸ Both regulatory bodies are struggling to devise a system that comports with the 1996 Act.¹⁹ The language of the universal service provision of the 1996 Act lends itself to contradictory interpretations that can be rationalized to support one's particular market biases.²⁰ The dilemma is exacerbated by the Commission's insistence on applying outmoded terminology, instituted under a monopolistic environment, to a new regulatory context driven by the goal of expanding competition in a post local-monopoly world.²¹ Essentially, the question is one of statutory interpretation. As stated, the FCC has set forth its take on Section 254 in its *Universal Service Order*, but it is doubtful that the Commission will have the last word.²²

eral-State Joint Board on Universal Service (Report to Congress), CC Dkt. No. 96-45, at 1 (Jan. 30, 1998) [hereinafter *SBC Comments*]; see also Reply Comments of GTE Service Corp., *In re Federal-State Joint Board on Universal Service* (Report to Congress), CC Dkt. No. 96-45, at 19 (Feb. 6, 1998) [hereinafter *GTE Reply Comments*].

⁹ See *AT&T Reply Comments*, *supra* note 7, at 11 (asserting that ISPs pose real competition to providers of long distance service, especially in the areas of real-time fax and voice transmissions).

¹⁰ The 1996 act states that only "telecommunications carrier(s)" will support universal service. 47 U.S.C. § 254(d)(Supp. 1997); see generally Catherine Yang, *Telecom: Congress Should Reform its Reform*, Bus. Wk, Jan. 12, 1998, at 40.

¹¹ See *AT&T Reply Comments*, *supra* note 7, at ii-iii.

¹² See *id.*

¹³ Soon, businesses like Qwest Communications Corp. will make serious grabs at long distance market share by offering Internet-based calling to U.S. customers. See Steven V. Brull, *At Seven And A Half Cents A Minute, Who Cares If You Can't Hear A Pin Drop?*, Bus. Wk, Dec. 29, 1997, at 46. This idea has come even closer to fruition with Qwest Corp.'s proposed merger with LCI. See Mike Mills, *LCI to be Acquired in \$4.4 billion Deal*, WASH. POST, March 10, 1998, at C1.

¹⁴ See *Airtouch Comments*, *supra* note 7, at 27 (arguing that ISPs should have to contribute to the USF); *But cf.* Comments of America Online, Inc., *In re Federal-State Joint Board on Universal Service* (Report to Congress), CC. Dkt. No. 96-45, at 21 (Jan. 26, 1998) [hereinafter *AOL Comments*] (contending that the 1996 Act does not allow the Commission to require ISPs to contribute to the USF).

¹⁵ 47 U.S.C. § 254 (Supp. 1997).

¹⁶ Section 254 of the 1996 Act is thus appropriately entitled, "Universal Service." *Id.*

¹⁷ Communications Act of 1934, Pub. L. No. 104-104, 110 Stat. 56 (codified as amended at 47 U.S.C. § 151 (Supp. 1997)).

¹⁸ See *id.*; see also Reply Comments of The Education and Library Networks Coalition, *In re Federal-State Joint Board On Universal Service* (Report to Congress), CC Dkt. No. 96-

45, at 1-2 (Feb. 6, 1998) [hereinafter *EDLINC Reply Comments*].

¹⁹ See Mike Mills, *Florida Seeks Higher Phone Rates to Expand Market*, WASH. POST, March 8, 1998, at A8 (reporting that state and federal regulators are "puzzling" over universal service).

²⁰ Senators Burns and Stevens warn: "Although some members of industry may support the Commission's approach in a shortsighted effort to obtain relief from access charges and other outdated regulatory structures, they are likely to be disappointed with the long-term result." Comments of Senators Burns and Stevens, *In re Federal-State Joint Board on Universal Service* (Report to Congress), CC Dkt. No. 96-45, at 5 (Jan. 28, 1998) [hereinafter *Burns and Stevens Comments*].

²¹ *Burns and Stevens Comments*, *supra* note 20, at 8. In expressing their disagreements with the FCC's implementation of Section 254, the Senators state, "Our greatest concern is that the Commission continues to apply concepts developed in an inflexible monopoly environment to the flexible, post-local-monopoly world that the Telecommunications Act was intended to create." *Id.*

²² Less than six weeks after the FCC released its *Universal Service Order*, SBC Communications, Inc. filed suit in the Eighth Circuit requesting that the court "hold unlawful, vacate, enjoin, and set aside" the Commission's Order, or at least stay those portions that provide federal support to schools and libraries for Internet access. . . and other non-telecommunications providers. See *SBC Asks FCC to Stay Universal Service Order*, COMM. TODAY, July 18, 1997, at 14. On March 9, 1998, America's Carriers Telecommunication Association (ACTA) asked a district court in the Fifth Circuit to hold the FCC's *Universal Service Order* unconstitutional in its entirety. ACTA contends that if Congress wants to raise funds for universal service purposes, it must do so by creating an explicit new tax, a power outside of the scope of the Commission's authority. See *ACTA Challenges Constitutionality of Universal Service* (visited Mar. 12, 1998) <<http://www.prnewswire.com:80/cgi-bin/sto...04&STORY=/www/story/3-9-98/431149&EDATE=>>.

A. The Controversy

The battle lines have been drawn. ISPs are thrilled with the FCC's interpretation of Section 254.²³ They undoubtedly look forward to receiving universal service support and expanding their market base at the expense of traditional telecommunications carriers.²⁴ Indeed, they have nothing to lose and everything to gain.²⁵ Many traditional telecommunications providers, on the other hand, are incensed by the FCC's proposed scheme.²⁶ Never before have the beneficiaries of universal service been anything but the providers of plain old telephone service ("POTS").²⁷ They assert that ISPs, who do not fit under the FCC's definition of "telecommunications carrier" and who offer a competitive alternative to traditional telecommunications services, should have to contribute their fair share to the universal service fund in the spirit of competitive neutrality, one of the central goals of the 1996 Act.²⁸

Part I of this note will provide a brief background on universal service and trace the dramatic evolution of this social policy to its present state. Part II illuminates the regulatory definitions the Commission has chosen to apply to Section 254. Part III discusses Section 254 and the FCC's plan to implement this section in its *Univer-*

sal Service Order.²⁹ Part IV sets forth the statutory arguments both for and against the FCC's universal service plan as it effects ISPs. Finally, part V contends there are only two acceptable interpretations of Section 254. The first option applies old regulatory terminology developed over decades of regulation, the result being that ISPs can neither take from, nor contribute to, the universal service fund. The second option incorporates a more up to date interpretation that sheds certain regulatory distinctions that have become irrelevant. Under this application, ISPs could benefit from the USF, but they would also be required to contribute to the USF in the same manner as other telecommunications carriers.³⁰

II. AN EVOLVING DEFINITION OF UNIVERSAL SERVICE

The concept of universal service has come a long way since the term was coined in 1907 by Theodore Vail, then president of AT&T.³¹ In Vail's time, universal service meant interconnectivity.³² The essential goal was that no matter what telephone company to which one subscribed, all subscribers of all companies would be able to talk to one another.³³ This definition of

²³ See *AOL Comments*, *supra* note 14, at 18.

²⁴ See, e.g., Kelley Holland, *Phone Subsidies Get An Overhaul*, *Bus. Wk.*, May 19, 1997, at 46; see also Yang, *supra* note 10.

²⁵ Again, this is due to the fact that, under the FCC's plan, Internet access will be subsidized by the USF, but ISPs will not have to contribute to the USF. See *AOL Comments*, *supra* note 14, at 21; see also *Universal Service Order*, 12 FCC Rcd. at 9179 para. 788.

²⁶ Roxana E. Cook, *All Wired Up: An Analysis of the FCC's Order to Internally Connect Schools*, 50 *FED. COMM. L.J.* 215, 217 (Dec. 1997) (citing that critics have, "denounced the subsidy as unsupported by the Act's language and outside the FCC's authority").

Before the passage of the 1996 Act, only long distance carriers supported universal service. As of January 1998, the federal USF will be supported by all interstate telecommunications carriers, including long distance companies, local telephone companies, cellular telephone companies, paging companies, and pay-phone service providers. See *Consumer Information: The FCC's Universal Service Support Mechanisms*, (visited Mar. 18, 1998) <Fact Sheet: <http://www.fcc.gov/Bureaus/Common Carrier/Factsheets/univers.html>>.

²⁷ Doug Abrahms, *AT&T Seeks Lower Fee to Reach Customers*, *WASH. TIMES*, Feb. 5, 1997, at B6 (quoting Rep. W.J. "Billy" Tauzin stating: "What I'm suggesting is keeping the universal service fund for what it is supposed to do—provide universal phone service").

²⁸ See *GTE Reply Comments*, *supra* note 8, at 21 (arguing that the Commission must find a more equitable approach in

order for the universal service mechanism to be competitively neutral).

²⁹ See generally *Universal Service Order*, 12 FCC Rcd. at 8776.

³⁰ This paper does not analyze whether subsidized Internet access for schools and libraries is sound policy. Rather, it distills the only two acceptable interpretations of Section 254, neither of which has been adopted by the Commission. However, for an illuminating discussion of this topic, see generally West, *supra* note 2. West contends that universal service subsidies are fundamentally incompatible in what is supposed to be a competitive deregulatory regime under the 1996 Act. *Id.*

³¹ See Richard E. Nohe, *A Different Time, A Different Place: Breaking Up Telephone Companies in the United States and Japan*, 48 *FED. COMM. L.J.* 307, 309 n.12 (1996).

³² See Milton Mueller, *Telecommunications Access In The Age of Electronic Commerce: Toward A Third-Generation of Universal Service Policy*, 49 *FED. COMM. L.J.* 655, 656 (1997).

³³ During Vail's time many local exchange markets had several carriers that offered basic telephone service. See Milton L. Mueller, Jr., *UNIVERSAL SERVICE: COMPETITION, INTERCONNECTION, AND MONOPOLY IN THE MAKING OF THE AMERICAN TELEPHONE SYSTEM*, 4-13 (1997). These carriers, however, could not interconnect with one another. See *id.* A subscriber to phone company A, could not pick up the phone and call a subscriber to phone company B. See *id.* Consequently, many businesses owned not just one, but several phones, and several phone company subscriptions. See *id.* Many, especially proponents of AT&T, argued that this

universal service lasted from 1907 to about 1965; a period some refer to as the "first generation" of universal service.³⁴

A second generation of universal service policy emerged around the same time the Bell monopoly began to feel the threat of competition in the long distance market.³⁵ From 1965-1996,³⁶ during the second generation, the concept of universal service grew to mean telephone service in every home at reasonable charges, regardless of geographic location.³⁷ Telephone service was considered an essential need, a utility, much like water or electric power service.³⁸ Universal service thus became social policy, a state of affairs that thrived under the Bell monopoly, and which survives to this day.³⁹

Regulators during the second generation thought that the market alone could not ensure that the goals of second generation universal service policy would be achieved.⁴⁰ Providing telecommunications services to sparsely populated rural areas was simply not profitable.⁴¹ Even if a

was economic waste; that telecommunications services should be provided in ubiquitous form by one regulated utility so that all subscribers would be interconnected. *See id.* This led to the Communications Act of 1934 under which AT&T submitted to regulatory oversight in return for a government sanctioned monopoly over the majority of the nation's telecommunications market. *See id.*

³⁴ Mueller traces the evolution of universal service in three steps. *See* Mueller, *supra* note 32, at 657-68. The first generation encompasses the period of 1907-1965. *See id.* This era began with widespread competition among phone companies and ended with a deeply entrenched Bell monopoly under the Communications Act of 1934. *See id.* The second generation (1965-1996) takes place amidst the slow chipping away of the Bell monopoly with the introduction of competition in long distance markets, the 1984 divestiture of the Bell system, and the regulation of the nation's telecommunications market under Judge Harold Greene's *Consent Decree*. *See id.* The third generation of Universal service represents what is to come under the Telecommunications Act of 1996. *Id.* Mueller contends that regulators incorrectly assumed the paradigms of second generation universal service (a uniform grade of service, reaching all homes at reasonable rates) could be successfully applied under the diverse and rapidly expanding new regime. *See id.*

³⁵ *See id.* at 657.

³⁶ *See id.*

³⁷ *See* West, *supra* note 2, at 165-66; *see generally* Communications Act of 1934, 47 U.S.C. § 9, et seq. (1994).

³⁸ Evidently, this policy assumed that a significant number of users could not afford to pay for monthly local telephone service, especially in rural areas. *See* Mueller, *supra* note 32, at 658.

³⁹ *See* Eli M. Noam, *Will Universal Service and Common Carriage Survive The Telecommunications Act of 1996?*, 97 COLUM. L. REV. 955, 956 (1997). Noam argues that universal service will endure despite its inherent friction with the competitive der-

local exchange carrier ("LEC") merely charged enough to recover its cost of providing service in rural regions, its rates still would have been economically prohibitive to most customers.⁴² Other telecommunications markets provided for better opportunities for a carrier. For example, a LEC could profit far more by serving large concentrated business customers than by serving scattered residential customers.⁴³ The newly competitive long-distance market also proved to be tremendously lucrative.⁴⁴ Consequently, in order to meet the new universal service goals, regulators manipulated rates through a series of subsidization mechanisms to ensure that the price of local phone service would be comparable nationwide.⁴⁵ Regulators authorized carriers to raise prices far above cost in the more profitable (low cost) areas of the telecommunications market so prices in the less profitable (high cost) markets could be kept down.⁴⁶ As a result of the new universal service policy, long-distance and business users subsi-

regulatory goals of the 1996 Act. *Id.* The longevity of universal service may have more to do with political dynamics than economic principles. *Id.* at 961.

⁴⁰ These supposed market deficiencies served to reinforce the legitimacy of the regulated Bell monopoly. *See* Miles W. Hughes, *Telecommunications Reform and the Death of the Local Exchange Monopoly*, 24 FLA. ST. U. L. REV. 179, 197 (1996).

⁴¹ In fact, prices based on actual costs are still economically prohibitive in most rural areas. *See* Comments of the Beehive Telephone Companies, *In re*, Federal-State Joint Board on Universal Service (Report to Congress), CC Dkt. No. 96-45, at 2 (Jan. 26, 1998) [hereinafter *Beehive Comments*]. For instance, the Beehive Telephone Co. requires a \$97 per month per subscriber universal service subsidy in order to make basic telephone service affordable for its subscribers. *Id.*

⁴² John N. Rose, *Universal Phone Support: It's Still a Good Idea*, BUS WK, June 2, 1997, at 12. Mr. Rose points out that, "there isn't a marketplace in the world that can overcome the extreme costs of operating in iron-hard mountains or soupy swamps—where the consumer population can be counted in the single digits." *Id.*

⁴³ Peter Knight, *Recent Developments In Information Technology In the Asia-Pacific Region (Part I)*, 14 COMPUTER LAWYER 19, 27 (March 1997).

⁴⁴ *The Lure of Distance*, ECONOMIST, April 6, 1996, at 63.

⁴⁵ Much of this subsidization took place via lop-sided access charges that Interexchange carriers would pay to local exchange carriers for the origination and termination of interstate calls, as well as rate averaging and high intrastate toll rates. *See* Jamie N. Nafziger, *Time to Pay Up: Internet Service Providers' Universal Service Obligations Under the Telecommunications Act of 1996*, 16 J. MARSHALL J. COMPUTER & INFO. L. 37, 43 (1997).

⁴⁶ *See* Mueller, *supra* note 32, at 658 (explaining that the policy taxed usage in order to subsidize access).

dized rural and residential users.⁴⁷

We are currently in the midst of the third generation of universal service policy.⁴⁸ This era began with the passing of the 1996 Act.⁴⁹ The basic tenants of the previous regime remain.⁵⁰ Regulators and legislators are as concerned as ever with ensuring that all people have access to telecommunications service at reasonable rates.⁵¹ There are, however, a few twists. First, universal service is no longer an intangible overarching policy goal.⁵² Congress condoned the years of implicit subsidies by codifying universal service policy in its very own section within the 1996 Act.⁵³ Second, the Act demands that universal service goals no longer be achieved via implicit cross-subsidies.⁵⁴ Under the new regime, the Act requires that universal service be funded through explicit contributions that will go into a universal service fund.⁵⁵ Third, unlike second generation universal service policy, there is no longer unanimity as to what carriers should contribute to, and what carriers should benefit from, the universal service fund.⁵⁶ Some would limit those beneficiaries to the providers of POTS as under the previous regime.⁵⁷ Others would extend universal service support to providers of what the FCC calls enhanced services, such as ISPs.⁵⁸ The final, and most striking char-

acteristic of third generation universal service policy is its glaring incompatibility with the competitive precepts of the Telecommunications Act.⁵⁹ The primary purpose of the Act was deregulation and the introduction of competition to local telephone markets.⁶⁰ Meanwhile, the FCC is expected to keep the market in check through regulation to ensure affordable access to telecommunications for all Americans.⁶¹ This only serves to fuel the current controversy over third generation universal service policy.⁶²

III. DEFINING OUR TERMS: SECOND GENERATION HOLDOVERS

Just as certain policies survived from second generation universal service into the third, certain terms were transplanted as well.⁶³ An understanding of how a few of these terms endured is critical to an appreciation of the current controversy.

A. The Basic/Enhanced Distinction

Under the second generation of universal service, telephone companies that held themselves out as common carriers both supported and benefitted from the overall mechanism.⁶⁴ During

the fund and that the providers of Internet access should nevertheless have to make USF contributions because they compete, to some extent, with phone companies. *See id.*

⁴⁷ *See Id.*; *See also* James Freeman, *Feds Hate the Web*, FORBES, Aug. 25, 1997, at S79 (stating that the general theory behind universal service is that "the provision of some services is too important to be left to the whims of the marketplace"). *Id.*; *but see* Amy Barrett, *But do Aspen and Vail Really Need Phone Subsidies?*, BUS. WK., May 12, 1997, at 43 (arguing that universal service subsidies commonly benefit those who have no need for it).

⁴⁸ The term "third generation universal service policy" is a variation on Mueller's three-chapter approach to universal service. The third generation embodies broader universal service goals that Congress supposedly sought to reach in Section 254 of the 1996 Act. *See generally* Mueller, *supra* note 32.

⁴⁹ *See id.* at 658-59.

⁵⁰ *See id.*

⁵¹ *See generally* Abrahms, *supra* note 27.

⁵² *See* Mueller, *supra* note 32, at 658.

⁵³ *See* 47 U.S.C.A. § 254 (1997 Supp.).

⁵⁴ The 1996 Act demands that universal service support mechanisms be specific and predictable. *Id.* at 254(d).

⁵⁵ *See* H.R. Conf. Rep. 104-458, at 131 (1996) *reprinted in* 1996 U.S.C.C.A.N. 124, 141-142; *see also* *Universal Service Order*, 12 FCC Rcd. at 9002 para. 425.

⁵⁶ For instance, America Online ("AOL") claims that Internet access for schools and libraries should be subsidized by the USF and that only telephone companies should have to contribute to the Fund. *See generally* *AOL Comments*, *supra* note 14. *But see* *AT&T Reply Comments*, *supra* note 7, at 11. AT&T argues that Internet access should not be supported by

⁵⁷ *See* Abrahms, *supra* note 27.

⁵⁸ *See* Ford, *supra* note 4 (arguing that giving school children access to the Internet is a prerequisite to their being able to stay afloat in the information age).

⁵⁹ *But see* CHAIRMAN WILLIAM KENARD, FCC, ADDRESS TO THE PRACTICING LAW INSTITUTE (Dec. 11, 1997, Washington, D.C.). "There have always been those who have said that you can't have competition and universal service. That's simply wrong. Quite to the contrary, we can have competition and have universal service. And we will." *Id.*

⁶⁰ *See* Alex J. Mandl, *Telecom Competition is Coming Sooner Than You Think*, WALL ST. J., Jan. 26, 1998, at A18 (criticizing the delays in meeting the 1996 Act's objectives); *see generally* Mills, *supra* note 13.

⁶¹ *See* West, *supra* note 2, at 159.

⁶² *See* Jim Chen, *The Legal Process and Political Economy of Telecommunications Reform*, 97 COLUM. L. REV. 835, 865 (1997) (citing the inherent contradiction between deregulation and universal service subsidization).

⁶³ *See generally* *Burns and Stevens Comments*, *supra* note 20, at 5-6 (criticizing the Commission for using an outdated definition of the term "telecommunications carrier").

⁶⁴ *See id.* The Senators point out that the term "telecommunications carrier" which Congress employs in the 1996 Act is derived from the term "common carrier" as set forth in the *NARUC II* decision. *See id.* at 6. In *NARUC II*, the court defined a common carrier as a service provider which, "holds

this period, universal service funds supported only "basic services."⁶⁵ Under the FCC's interpretation, basic services constituted, "common carrier offering(s) of transmission capacity for the movement of information."⁶⁶ This primarily encompassed plain old telephone service or POTS.⁶⁷

The FCC designated another class of services as "enhanced services."⁶⁸ According to the regulatory definition, enhanced services combined basic services with "computer processing applications that act on the format, content, code, protocol, or other similar aspects of the subscriber's information."⁶⁹ Internet transmissions can involve both computer processing and protocol conversion.⁷⁰ Consequently, under the FCC's definition of enhanced service, an ISP would be considered an enhanced service provider, and thus Internet access would constitute an enhanced service.⁷¹

B. The Telecommunications/Information Distinction

This second generation basic/enhanced dis-

inction crept into third generation universal service policy.⁷² The Commission has substituted the terms "basic" and "enhanced" with "telecommunications" and "information," respectively.⁷³ It appears that basic service, under the old regime, is now considered telecommunications service, and much of what was previously considered enhanced service is now information service.⁷⁴ An example of a telecommunications service under the FCC's current scheme would be POTS.⁷⁵ Accordingly, the provider of this service is classified as a "telecommunications carrier."⁷⁶ In contrast, an example of an information service under the third generation regime would be Internet access.⁷⁷ The provider of Internet access, therefore, is an ISP.⁷⁸ Whether the FCC's decision to distinguish between Internet services and telecommunications services is appropriate will be addressed later.⁷⁹ For now, it is important to recognize that the Commission distinguishes between the two.⁸⁰

itself out indifferently to serve to all potential users," and allows those users to, "transmit intelligence of their own design and choosing." *National Ass'n. of Regulatory Utility Commissioners ("NARUC") v. FCC*, 553 F.2d 601, 608-09 (D.C. Cir. 1976).

⁶⁵ See *In re* Amendment of Section 64.702 of the Commission's Rules and Regulations (Second Computer Inquiry), 77 F.C.C. 2d 384, 387 at para. 5 (1980), *modified*, 84 F.C.C. 2d 50 (1980), *further modified on reconsideration*, 88 F.C.C. 2d 512 (1981) [hereinafter *Computer II*].

⁶⁶ *Id.*

⁶⁷ See *id.* at 418 para. 90.

⁶⁸ See 47 C.F.R. § 64.702 (1997). The rule states in relevant part: "the term *enhanced services* shall refer to services, offered over common carrier transmission facilities used in interstate communications, which employ computer processing applications that act on the format, content, code, protocol or similar aspects of the subscriber's transmitted information." *Id.*

⁶⁹ *Id.*; see also *Computer II*, 77 F.C.C. 2d, at 498 app. 1 (a).

⁷⁰ See *Universal Service Order*, 12 FCC Rcd., at 9321 app. I.

⁷¹ See *id.*

⁷² See *Burns and Stevens Comments*, *supra* note 20, at 5 (noting that, "The Commission's continued classification of services as 'enhanced' or 'basic' could seriously undermine the competitive regime Congress sought to create").

⁷³ See *Id.*; see also Kevin Werbach, *Digital Tornado: The Internet and Telecommunications Policy*, OPP Working Paper No. 29, (visited Mar. 19, 1998) < http://www.fcc.gov/Bureaus/OPP/working_papers/oppwp29.txt > .

⁷⁴ See *Burns and Stevens Comments*, *supra* note 20, at 8. The Senators assert that Congress did not intend this to be the case. *Id.*

⁷⁵ See *In re* Application of Ameritech Michigan Pursuant to Section 271 of the Communications Act of 1934, as Amended, To Provide In-Region, Interlata Services to Michigan, *Memorandum Opinion and Order*, 9 Com. Reg. (P&F) 267, 320 n. 433 (1997).

⁷⁶ See 47 U.S.C. § 153 (44) (1994) (defining a telecommunications carrier as, "any provider of telecommunications services").

⁷⁷ The 1996 Act defines an information service as, "the offering of a capability for generating, acquiring, storing, transforming, processing, retrieving, utilizing, or making available information via telecommunications. . ." 47 U.S.C. § 153 (20) (Supp. 1997).

⁷⁸ See *In re* Access Charge Reform Price Cap Performance Review for Local Exchange Carriers, *Notice of Proposed Rulemaking*, 11 FCC Rcd. 21354, 21364 para. 19 (1996) (stating: "we also discuss possible changes to our existing treatment of the use by interstate information service providers, such as *Internet service provider*") (emphasis added).

⁷⁹ The author contends that this distinction is an unfortunate policy choice based on out-dated regulatory terminology.

⁸⁰ See *Universal Service Order*, 12 FCC Rcd. at 9178 para. 785, 9180 para. 789. The distinguishing factor between a telecommunications service and an information service is what is known as protocol conversion. *Id.* at para. 439. Protocol conversion is a functional capability of an information service that allows for communication to take place between disparate terminals or networks. See *In re* Petition for a Declaratory Ruling That AT&T's Frame Relay Service is a Basic Service, *Memorandum Opinion and Order*, 10 FCC Rcd. 13, 717 n.5 (1995).

IV. SECTION 254 AND THE COMMISSION'S UNIVERSAL SERVICE ORDER

A. Section 254

Section 254 is the embodiment of third generation universal service policy.⁸¹ It is also the battlefield for the current controversy over ISPs and the USF.⁸² Problems arise when determining exactly what entities and what services Congress intended would support the USF, and what entities and services would be the beneficiaries of the USF.⁸³ This state of affairs is primarily due to the fact that Section 254 is an almost cruel exercise in legislative doublespeak. Understanding this dilemma requires a close and somewhat tedious look at Section 254.

1. 254(b)(6) and 254(c)(3)

Section 254(b)(6) is entitled: "Access to Advanced Telecommunications Services for Schools, Health Care, and Libraries."⁸⁴ This provision states that, "Elementary and secondary schools and classrooms, health care providers, and libraries should have access to advanced telecommunications services *as described in subsection (h)*."⁸⁵ Similarly, subsection (c)(3) states that, "[T]he Commission may designate additional services for such support mechanisms for schools, libraries, and health care providers *for the purposes of subsection (h)*."⁸⁶

2. 254(h)(1)(B)

Proceeding dutifully to subsection (h) one would expect to find some explanation of what

Congress means when it uses terms such as "advanced telecommunications services" and "additional services."⁸⁷ This, of course, would be all too easy. Instead, one finds subsections (h)(1)(B) and (h)(2)(A).⁸⁸ Subsection (h)(1)(b) informs that, "All telecommunications carriers shall provide such services to elementary schools, secondary schools, and libraries for educational purposes at rates less than the amounts charged for similar services to other parties."⁸⁹ In order to decipher what Congress meant by "such services," the reader is almost mockingly referred back to subsection (c)(3), the provision that got them there in the first place.⁹⁰

The subsection then goes on to say that any telecommunications carrier that provides service under (h)(1)(B) should either be reimbursed through universal service mechanisms or have their universal service contribution reduced accordingly.⁹¹ Unfortunately, however, (h)(1)(B) makes no reference to Internet service providers, or providers of advanced services.⁹² It speaks only of telecommunications carriers.⁹³ Again, according to the Commission's interpretation, ISPs are considered to be enhanced service providers or information service providers, not telecommunications carriers.⁹⁴ Thus, subsection (h)(1)(B)'s applicability to ISPs appears a bit tenuous under the Commission's current classification of that term.⁹⁵

3. 254(h)(2)(A)

It is much easier to find a place for ISPs in subsection (h)(2)(A), entitled, "Advanced Services."⁹⁶ This provision instructs the Commission

⁸¹ See Mueller, *supra* note 32, at 658.

⁸² See generally SBC Comments, *supra* note 8 (arguing that Section 254 does not allow ISPs to receive federal universal service support).

⁸³ See Airtouch Comments, *supra* note 7, at 20. Airtouch lays out the two issues of universal service policy design rather concisely: "(a) Which consumers and carriers, and which services, are eligible for support? and (b) Which consumers and carriers have to bear the costs of universal service programs?" *Id.*

⁸⁴ 47 U.S.C. § 254(b)(6) (Supp. 1997).

⁸⁵ *Id.*

⁸⁶ *Id.* at (c)(3).

⁸⁷ Section 153, the provision that defines the terms used in the Act, does not define either term. 47 U.S.C. § 153 (Supp. 1997).

⁸⁸ 47 U.S.C. § 254(h)(1)(B), (h)(2)(A) (Supp. 1997).

⁸⁹ *Id.* at (h)(1)(B).

⁹⁰ *Id.* at (c)(3).

⁹¹ *Id.* at (h)(1)(B)(i), (ii)

⁹² *Id.*; see also SBC Comments, *supra* note 8, at 4.

⁹³ See 47 U.S.C. § 254 (h)(1)(B) (Supp. 1997).

⁹⁴ See *In re Access Charge Reform, First Report and Order*, 12 FCC Rcd. 15982, 16165 para. 430 (1997); see also *The FCC, Internet Service Providers, and Access Charges* (visited Feb. 19, 1998)

<http://www.fcc.gov/Bureaus/Common_Carrier/Factsheets/ispfact.html>.

⁹⁵ See SBC Comments, *supra* note 8, at 4 (arguing that the services supported under 254(h)(1)(A) and (h)(1)(B) are limited to telecommunications services, thereby excluding Internet service).

⁹⁶ 47 U.S.C. § 254(h)(2)(A) (Supp. 1997).

to, "enhance, to the extent technically feasible and economically reasonable, access to advanced telecommunications and *information services* for all public and non-profit elementary and secondary school classrooms, health care providers and libraries."⁹⁷ ISPs fit comfortably into the definition of information services because Internet access allows one to "generate, store, retrieve, and utilize information via telecommunications."⁹⁸ But unlike subsection (h)(2)(B), this paragraph does not stipulate any type of universal service mechanism through which access to advanced services should be enhanced.⁹⁹ Nowhere in subsection (h)(1)(A) is there any reference to support for advanced services, contributions for such support, or any sort of reimbursement process in return for discounting those services.¹⁰⁰ Subsection (h)(2)(A) merely sets forth a rather ambiguous policy statement that access to advanced services should be enhanced in a competitively neutral manner.¹⁰¹

4. 254(e)

To complicate matters just a tad more, Section 254(e) states, "only an eligible *telecommunications carrier* shall be eligible to receive specific Federal universal service support."¹⁰² If only telecommunications carriers are eligible for universal service support, and Internet service providers are not telecommunications carriers, then could Con-

gress have intended that ISPs be supported by the universal service fund?¹⁰³

B. The Universal Service Order

Congress left the onerous burden of implementing these provisions to a federal-state joint board and the FCC.¹⁰⁴ Not only did the joint board, and ultimately the Commission, have to interpret the legislative labyrinth that is Section 254, it also had to devise a scheme by which the goals of third generation universal service policy would be realized within a competitive deregulatory context.¹⁰⁵ Based on the recommendations of a federal-state joint board, the Commission was to ensure that universal service contributions would be made through explicit and predictable mechanisms and that those contributions would be equitable and non-discriminatory.¹⁰⁶

In its *Universal Service Order*, the Commission established the \$2.5 billion federal USF for the benefit of schools and libraries.¹⁰⁷ It ordered all telecommunications carriers to make contributions to the fund based on their gross revenues.¹⁰⁸ Only carriers whose contributions would be *de minimis* could be exempt from the contribution requirement.¹⁰⁹ As for the beneficiaries of the newly established universal service fund, the Commission concluded that the language of Section 254 authorized it to designate Internet access to schools and libraries for universal service fund support.¹¹⁰

⁹⁷ *Id.*

⁹⁸ 47 U.S.C. § 153 (20) (Supp. 1997).

⁹⁹ 47 U.S.C. § 254 (h)(2)(B) (Supp. 1997).

¹⁰⁰ *See id.* at (h)(1)(A).

¹⁰¹ 47 U.S.C. § 254(h)(2)(A) (Supp. 1997).

¹⁰² 47 U.S.C. § 214(e) (Supp. 1997).

¹⁰³ The legislative history seems to indicate an intent on the part of Congress to allow ISPs to benefit from universal service. *See Burns and Stevens Comments, supra* note 20, at 12. In referring to the provisions of subsection (h), the conference agreement stated, "They are intended, for example, to provide the ability to browse library collections, review the collections of museums, or find new information on the treatment of an illness, to Americans everywhere via schools and libraries. 142 CONG. REC. H1113 (daily ed. Jan. 31, 1996). The conference agreement is obviously speaking to Internet access. Additionally, it states the Commission could, "determine that telecommunications and information services that constitute universal service for classrooms and libraries shall include . . . information services which can be carried over the Internet." *Id.*

¹⁰⁴ *See* 47 U.S.C. § 254(a)(1), (2) (Supp. 1997). The section requires the FCC to convene a Federal-State joint board that would make recommendations to the Commission as to how Section 254 would be implemented. The Commission

was given 15 months from the enactment of the 1996 Act in which to decide upon the joint board's recommendations. *Id.*

¹⁰⁵ Many commentators assert that such a task is theoretically impossible due to the inherent contradictions between subsidization (which the USF necessitates) and deregulation (which competition necessitates). *See West, supra* note 2, at 182-83.

¹⁰⁶ *See id.* at (b)(4).

¹⁰⁷ *Universal Service Order*, 12 FCC Rcd., at 9002 para. 425.

¹⁰⁸ *See id.* at 9171 para. 773. The contribution requirement is approximately 4 percent of a telecommunications carrier's gross revenues. *See Consumer Information: The FCC's Universal Support Mechanisms* (visited Mar. 18, 1998) <Fact Sheet: <http://www.fcc.gov/Bureaus/Common Carrier/Factsheets/univers.html>>.

¹⁰⁹ *See* 47 U.S.C. § 254(d) (Supp. 1997). "The Commission may exempt a carrier or class of carriers from the requirement if the carrier's telecommunications activities are limited to such an extent that the level of such carrier's contribution to the preservation and advancement of universal service would be *de minimis*." *Id.*

¹¹⁰ *See Universal Service Order*, 12 FCC Rcd., at 9002 para. 425. The Commission also concluded that eligible schools and libraries would be able to receive USF support for all

The Commission found that service providers would be eligible for discounts for Internet access whether or not the entity provided only Internet access or offered Internet access as one of its service options.¹¹¹ The Commission limited contributors, on the other hand, to providers of telecommunications services.¹¹²

V. THE DEBATE BETWEEN THE AOL CAMP AND THE AT&T CAMP

A. The Sides

The Commission is in the midst of preparing a Report to Congress on the implementation of Section 254.¹¹³ It has requested comments from interested parties regarding the overall universal service scheme set forth in the *Universal Service Order*.¹¹⁴ The comments demonstrate that two distinct factions exist, one for and the other against the Commission's treatment of ISPs in the *Universal Service Order*.

For simplicity's sake, the supporters of the Commission's *Universal Service Order* will be referred to herein as the AOL camp.¹¹⁵ The opponents of the *Universal Service Order*, as it effects ISPs, will be referred to herein as the AT&T camp.¹¹⁶

telecommunications services and internal connections provided by telecommunications carriers. *See id.*

¹¹¹ *See Universal Service Order*, 12 FCC Rcd., at 9086-87 para. 594 (finding that "Section 254(h)(2), in conjunction with section 4(i), permits us to empower schools and libraries to take the fullest advantage of competition to select the most cost effective provider of Internet access and internal connection").

¹¹² *See id.* at 9179-81 para. 788-89.

¹¹³ The Commission is required to conduct a thorough reevaluation of who is required to contribute to universal service. The due date for the report is April 10, 1998. *In re Federal-State Joint Board on Universal Service*, CC Dkt. No. 96-45, *Fourth Order on Reconsideration*, FCC 97-420, para. 255 (rel. Dec. 30, 1997).

¹¹⁴ *See Common Carrier Bureau Seeks Comment for Report to Congress on Universal Service Under the Telecommunications Act of 1996* (visited Mar. 18, 1998) <http://www.fcc.gov/Bureaus/Common_Carrier/Public_Notices/1998/da980002.html>.

¹¹⁵ The "AOL camp" includes: America Online, Inc., The Internet Service Provider Consortium ("ISP/C"), and The Education and Library Networks Coalition ("EDLINC").

¹¹⁶ The "AT&T camp" includes AT&T Corp., Southern Bell Communications, Inc., GTE Service Corp., and Airtouch Communications, Inc. Neither the AT&T camp nor the AOL camp constitute a complete list of players involved in the current controversy. They represent a select list of major players on both sides of the issue. For a complete list of the interested parties in the Report to Congress on Universal Service, *see Comments: Report to Congress on Universal Service, CC Docket*

B. Statutory Arguments in Support of Extending USF Support for Discounts on Internet Access for Schools and Libraries: The AOL Camp

Both the FCC and supporters of its decision on Internet access for schools and libraries make detailed arguments in favor of the Commission's interpretation of Section 254.¹¹⁷ They base their contentions on what they believe to be Congress' intent and the discretion that should be given to the FCC in interpreting that intent.¹¹⁸ Quite naturally, the ISPs who will be providing Internet access to schools and libraries are pleased with the Commission's interpretation of Section 254.¹¹⁹ They undoubtedly look forward to taking a slice of the \$2.5 billion that will be raised, courtesy of telecommunications carriers.¹²⁰

To reiterate, the FCC reasoned that Section 254 permitted it to extend USF support for Internet access to schools and libraries.¹²¹ According to this interpretation, a provider of Internet access, regardless of whether or not it is an ISP or a telecommunications carrier that provides basic services in addition to Internet services, will provide Internet access to schools and libraries at discounted rates.¹²² The providers of Internet services will then be reimbursed through the USF, or

No. 96-45 (visited Mar. 16, 1998) <http://www.fcc.gov/Bureaus/Common_Carrier/Comments/report2congress/rtccom.html>.

¹¹⁷ There has been extensive opportunity to comment on the FCC's Joint Board decision through the submission of comments and reply comments by all interested parties. The Commission has requested these comments in preparation of its Report to Congress. The Report is due on April 10, 1998. *Federal-State Joint Board on Universal Service*, Fourth Order on Reconsideration, CC Dkt. No. 96-45, para. 255 (rel. Dec. 30, 1997).

¹¹⁸ The legislative history indicated that Congress intended to ensure that eligible schools and libraries have affordable access to modern telecommunications and information services that will enable them to provide educational services to all parts of the nation. *See Universal Service Order*, 12 FCC Rcd. at 9002 para. 424; *see also EDLINC Reply Comments, supra* note 18, at 2; *see also Chevron v. Natural Resources Defense Council*, 467 U.S. 837 (1984) (holding in part that a federal agency has broad discretion where legislative language is subject to interpretation).

¹¹⁹ *See Conference Panelists Discuss Future of Subsidies, Regulation in Wake of Internet's Growth*, TELECOMMUNICATION REPORTS, Mar. 16, 1998, 1998 WL 8485963.

¹²⁰ *See Mike Mills, FCC Approves Restructuring of Nation's Telephone Rates; Consumers See Cuts of About 8% on Long Distance Phone Bills*, WASH. POST, May 8, 1997, at E1.

¹²¹ *See Universal Service Order*, 12 FCC Rcd., at 9008-09 para. 436.

¹²² *See id.* at 9015 para. 449.

have their mandatory contribution to the fund, in the case of telecommunications/Internet providers, reduced accordingly.¹²³ Because an ISP is not a telecommunications carrier, ISPs are exempt from USF contributions.¹²⁴ The Commission found such authority in sections 254(c)(3) and 254(h)(2).¹²⁵ The FCC reasoned that the language of Section 254(c)(3), giving it the authority to "designate additional services for support," permitted it to designate non-telecommunications services for support such as Internet access.¹²⁶ Proponents of this interpretation contend that if Congress wanted to limit the range of possible services only to telecommunications services, it would have explicitly done so by incorporating the term, "additional *telecommunications* services" instead of using the term, "additional services" in Section 254(c)(3).¹²⁷ They also cite to sections 254(h)(1)(B)¹²⁸ and 254(h)(2)(A),¹²⁹ arguing

¹²³ See *id.*

¹²⁴ See *id.* at 9498 para. 283 (noting PacTel's concern that allowing non-telecommunications carriers, such as ISPs, to draw from the USF without making them contribute creates an unfair subsidy for enhanced service providers).

¹²⁵ *Universal Service Order*, 12 FCC Rcd., at 9002 para. 425. It is important to keep in mind that there is no statutory debate as to whether telecommunications service should be supported by the USF. Congress was quite clear in its intent to have telecommunications supported in Section 254(h)(1)(B). 47 U.S.C. § 254(h)(1)(B); see also *Universal Service Order*, 12 FCC Rcd., at 9003 para. 425.

¹²⁶ See *id.* at 9009, para. 437.

¹²⁷ 47 U.S.C. § 254(c)(3). "In addition to the services included under the definition of universal service under paragraph (1), the Commission may designate additional services for such support mechanisms for schools, libraries, and rural health care providers for the purpose of subsection (h)." *Id.* See Comments of America Online, Inc., *In re* Federal-State Joint Board on Universal Service (Report to Congress), CC Dkt. No. 96-45, at 19 (Jan. 26, 1998) [hereinafter *AOL Comments*]. AOL further asserts that, "[I]n light of accompanying legislative history, this interpretation makes sense. For example, Congress noted that the FCC could include 'dedicated data links and the ability to gain access to educational materials, research information, statistics, information on government services, reports developed by Federal, State, and local governments, and information services which can be carried over the Internet.'" (citing H.R. CONF. REP. NO. 104-458, at 133, *reprinted in* 142 CONG. REC. H1113 (daily ed. Jan. 31, 1996)). AOL concludes that, "[G]iven this language, the inclusion of 'Internet access' among the supportable services is entirely reasonable." See *AOL Comments*, *supra* note 14, at 19 n. 72.

¹²⁸ 47 U.S.C. § 254(h)(1)(B):

(B) Educational Providers and Libraries. All telecommunications carriers serving a geographic area shall, upon a bona fide request from for any of its services that are within the definition of universal service under subsection (c)(3), provide such services to elementary

that the Commission could appropriately conclude that Congress intended for "advanced" and "information" services to be subsidized by the USF.¹³⁰

Proponents of the *Universal Service Order* also claim that the Commission acted within its statutory authority under section 4(i).¹³¹ This is the generic catch-all authority given to the Commission to "perform any and all acts, make such rules and regulations, and issue such orders, not inconsistent with this Act, as may be necessary in the execution of its functions."¹³² Consequently, commenters such as EDLINC argue that even though the language of Section 254 does not explicitly give the Commission authority to extend USF discounts for Internet access, the FCC stayed appropriately within its discretionary rulemaking boundaries in doing so.¹³³

schools, secondary schools, and libraries for educational purposes at rates less than the amounts charged for similar services to other parties. . . . A telecommunications carrier providing service under this paragraph shall—

(i) have an amount equal to the discount treated as an offset to its obligation to contribute to the mechanisms to preserve and advance universal service, or

(ii) notwithstanding the provisions of subsection (e) of this section, receive reimbursement utilizing the support mechanisms to preserve and advance universal service.

Id.

¹²⁹ 47 U.S.C. § 254(h)(2)(A):

(2) Advanced Services.—The Commission shall establish competitively neutral rules—

(A) to enhance, to the extent technically feasible and economically reasonable, access to advanced telecommunications and information services for all public and non-profit elementary and secondary school classrooms, health care providers, and libraries. . . .

Id.

¹³⁰ See *AOL Comments*, *supra* note 14, at 19.

¹³¹ See *EDLINC Reply Comments*, *supra* note 18, at 3. Section 4(i) empowers the Commission to make any rules, and take any acts necessary, in order to carry out its mandates. See 47 U.S.C. § 4(i) (1994).

¹³² 47 U.S.C. § 4(i) (1994).

¹³³ See *EDLINC Reply Comments*, *supra* note 18 at 3; *but see*, *Iowa Utilities Bd. v. FCC*, 120 F.3d 753 (8th Cir. 1997). In *Iowa*, the Eighth Circuit rejected the FCC's generic authority under 4(i) and 303(r) as authorization to promulgate intrastate pricing and contracting rules for interconnection agreements because this action went beyond the statutory language of sections 251 and 252 and conflicted with the language of section 2(b) of the Act. The Eighth Circuit found that, "these subsections merely supply the FCC with ancillary authority to issue regulations that may be necessary to fulfill its primary directives contained elsewhere in the statute. Neither subsection confers additional substantive authority on the FCC." *Id.* at 795. See also *People of the State of California v. FCC*, 905 F.2d 1217, 1240 n.35 (9th Cir. 1990).

C. Arguments Against the FCC's Interpretation of Section 254: The AT&T Camp

Telecommunications providers such as GTE, SBC Communications and AT&T point out serious flaws in the FCC's decision to extend USF support for Internet access.¹³⁴ They argue that the FCC's new universal service scheme deviates substantially from what Section 254 allows.¹³⁵ Understandably, providers of telecommunications services do not look forward to subsidizing discounts given by ISPs with their USF contributions.¹³⁶

While supporters of the FCC's decision cite to the ambiguities of Section 254 and the Commission's ability to interpret those ambiguities as it deems appropriate,¹³⁷ the statutory language cited by the opponents of subsidized Internet access for schools and libraries is quite clear.¹³⁸

For instance, critics point out that Section 254(e) states unequivocally that "only an eligible *telecommunications carrier*" may receive universal service support.¹³⁹ Considering that the FCC does not currently view ISPs as telecommunications carriers,¹⁴⁰ it appears the Commission is ignoring, or at least stretching, the language of 254(e) by including ISPs as the beneficiaries of the USF in its *Universal Service Order*.¹⁴¹

Opponents also cite Sections 254(c)(1), (c)(3) and (h), all of which refer to "telecommunications services."¹⁴² They argue that any reference

to "advanced services" must be viewed in the section's proper context as an advanced *telecommunications* service, thus excluding Internet access.¹⁴³ Accordingly, AT&T contends that "the expansive interpretation of 'advanced services' to include non-telecommunications services . . . simply cannot be sustained by the plain meaning, intent, or legislative history of [Section 254]."¹⁴⁴

Some of the most convincing evidence cited by the AT&T camp in arguing that Congress did not intend for Internet access to be supported by the USF comes from Congress itself.¹⁴⁵ In a letter to Chairman Kennard, Senators Burns and Stevens observe that "[I]f Internet conduit service is not a telecommunications service, then that service can never be supported as part of universal service under the terms of Section 254."¹⁴⁶ Indeed, the Senators assert that they, "debated and decided in Section 254 whether or not information services would be directly supported by universal service, and the answer was clearly not . . . [t]he Commission cannot use its generic authority to trump the unambiguously expressed intent of Congress."¹⁴⁷

D. Having Their Cake and Eating it Too: Arguments in Support of the FCC's Decision to Exempt ISPs from USF Contributions

Of course, ISPs, such as AOL, who claim they

¹³⁴ See *SBC Comments*, *supra* note 8, at 1 (arguing that Congress did not intend for ISPs to receive federal universal service support); see also *AT&T Reply Comments*, *supra* note 7, at 9 (contending that ISPs should have to contribute to the USF based on annual revenues); see also *GTE Reply Comments*, *supra* note 8, at 19 (asserting that the FCC should devise a system in which all telecommunications service providers are treated consistently).

¹³⁵ See *GTE Reply Comments*, *supra* note 8, at 19.

¹³⁶ See *SBC Comments*, *supra* note 8, at 1. These discounts also apply to inside wire services or internal connections. See *Universal Service Order*, 12 FCC Rcd. at 9002 para. 425.

¹³⁷ See *EDLINC Comments*, *supra* note 18, at 2; see also *Chevron v. Natural Resources Defense Council*, 476 U.S. 837 (1984) (holding that a government agency can apply a reasonable interpretation to an ambiguous statute).

¹³⁸ See *SBC Comments*, *supra* note 8, at 4 (citing Section 254(e) which limits universal service support to eligible telecommunications carriers).

¹³⁹ 47 U.S.C. § 254(e) (Supp. 1997).

¹⁴⁰ See *Universal Service Order*, 12 FCC Rcd at 9180 para. 789; see also *Burns and Stevens Comments*, *supra* note 20, at 8 (stating that, "The Commission in the *Universal Service Order* concludes that Internet access services are information services and not telecommunications services"). *Id.*; but see *In re*

Federal-State Joint Board on Universal Service, Report to Congress, CC Dkt. No. 96-45, FCC-98-67, at 4 (April 10, 1998). In its report to Congress, the Commission came very close to labeling one new Internet service as a telecommunications service, namely, IP (Internet Protocol) telephony. See *id.* The Commission, however, chose quite diplomatically to forego a definitive pronouncement on the issue until a more complete record is made. See *id.*

¹⁴¹ See *Universal Service Order*, 12 FCC Rcd. 9002 para. 425.

¹⁴² See *SBC Comments*, *supra* note 8, at 3-4.

¹⁴³ See *id.* This would also exclude other non-telecommunications services that the FCC designated for support such as internal connections. See *id.*

¹⁴⁴ See *AT&T Reply Comments*, *supra* note 7, at 10.

¹⁴⁵ See *GTE Comments*, *supra* note 8, at 21.

¹⁴⁶ *Burns and Stevens Comments*, *supra* note 20, at 9.

¹⁴⁷ See *Burns and Stevens Comments*, *supra* note 20, at 14. In speaking of the Commission's generic authority, the Senators are referring to section 4(i). "The Commission may perform any and all such acts, make such rules and regulations, and issue such orders, not inconsistent with this Act, as may be necessary in the execution of its functions." 47 U.S.C. § 154(i) (Supp. 1997).

should reap the benefits of the USF, are just as quick to hail the FCC's decision to exempt ISPs from having to make contributions to the fund.¹⁴⁸ They find support in Section 254(d) entitled, "Telecommunications Carrier Contribution."¹⁴⁹ AOL aptly points out that the 1996 Act only appears to require universal service contributions from telecommunications carriers.¹⁵⁰ They reason, "[B]ecause Internet access services are not telecommunications services, the FCC correctly excluded them [ISPs] from its list of 'contributing carriers'."¹⁵¹

Alternatively, members of the AOL camp claim that ISPs do actually contribute to the USF through their purchases of necessary telecommunications services.¹⁵² They note the billions of dollars they pay in telecommunications services every year.¹⁵³ They claim that with each purchase of telecommunications services, such as business lines, ISPs make an implicit, indirect contribution to the USF.¹⁵⁴ AOL contends that if it were to have to make explicit contributions, in addition to having to buy telecommunications service for its operations, the end result would be a discriminatory double tax.¹⁵⁵

E. Competitive Neutrality: The AT&T Camp Argues That ISPs Should Make Explicit Contributions to the USF

Members of the AT&T camp contend that it is

¹⁴⁸ See *AOL Comments*, *supra* note 14, at 21 (claiming that the 1996 Act only requires telecommunications carriers to contribute to the USF).

¹⁴⁹ 47 U.S.C. § 254(d).

¹⁵⁰ See *AOL Comments*, *supra* note 14, at 21. ". . . [E]very telecommunications carrier that provides interstate telecommunications services shall contribute. . . to preserve and advance universal service." 47 U.S.C. § 254(d) (Supp. 1997).

¹⁵¹ See *AOL Comments*, *supra* note 14, at 21 (citing *Universal Service Order*, 12 FCC Rcd. at 9179 para 788, 9181 para. 790).

¹⁵² See Reply Comments of America Online, Inc., *In re Federal-State Joint Board on Universal Service* (Report to Congress), CC Dkt. No. 96-45, at 6 (Feb. 6, 1998) [hereinafter *AOL Reply Comments*].

¹⁵³ See *id.*

¹⁵⁴ See *id.* at 7. The Commission agreed with this argument in its April 10 Report to Congress. See *In re Federal-State Joint Board on Universal Service, Report to Congress*, CC Dkt. 96-45, FCC 98-67, at 4 (April 10, 1998).

¹⁵⁵ See *id.*

¹⁵⁶ See *AT&T Reply Comments*, *supra* note 7, at 11.

¹⁵⁷ See *id.* at 12. AT&T vehemently contends that an ISP's purchase of interstate telecommunications services does not constitute a contribution to the USF. *Id.* An ISP's

only fair for ISPs, who will be eligible for billions of dollars in USF support under the FCC's plan, to be required to contribute to the fund based on their annual retail revenues.¹⁵⁶ They claim that indirect USF support paid for by ISPs through the purchase of telecommunications services is negligible compared to the contribution amount that would result if ISPs had to pay-in based on retail sales.¹⁵⁷ The result is telecommunications carriers will pay more into the USF than they would have to if ISPs contributed on the same basis.¹⁵⁸

Unfortunately for telecommunications carriers disaffected by the FCC's scheme, they are unable to overcome AOL camp's argument that Section 254(d) only requires telecommunications carriers to contribute to universal service.¹⁵⁹ The language of Section 254(d) is quite clear.¹⁶⁰ The AT&T camp's fairness argument, however, is rather strong, especially in light of the fact that ISPs do compete, to some extent, with telecommunications carriers.¹⁶¹ E-mail and Internet telephony are clear examples of such competition.¹⁶² Forcing one group of market players to subsidize another group of competing market players undoubtedly violates the precepts of competitive neutrality, a concept upon which the *Universal Service Order* is supposedly based.¹⁶³

In sum, the AOL camp's interpretation of Section 254 applauds the FCC's *Universal Service Or-*

contribution to the USF would be much higher if that contribution was based on the ISP's retail revenues. *Id.* Because ISPs are currently exempt from making such contributions, Interexchange carriers, such as AT&T, are forced to make up the difference. *Id.*

¹⁵⁸ See *id.*

¹⁵⁹ See generally *SBC Comments*, *supra* note 8.

¹⁶⁰ See 47 U.S.C. § 254(d) (stating that only telecommunications carriers shall contribute to universal service).

¹⁶¹ AT&T claims that Inter-exchange carriers ("IXCs") are increasingly having to compete with ISPs in the areas such as real-time fax and voice. See *AT&T Comments* at 11. See also Comments of Airtouch Communications, Inc., *In re Federal-State Joint Board on Universal Service* (Report to Congress), CC Dkt. No. 96-45, at 28-33 (Jan. 26, 1998) [hereinafter *Airtouch Comments*] ("The uneven treatment of ISPs relative to other users of the public switched network will create additional problems as ISPs become increasingly competitive with carriers that are forced to pay universal service taxes . . . ISPs will be competing against IXCs whose rates reflect the fact that their services have to bear subsidy burdens"). See *id.*

¹⁶² See Nick Denton, *Telephones on the Receiving End*, FINANCIAL TIMES, Jan. 14, 1998, at 26.

¹⁶³ BellSouth makes the point quite succinctly: "Having

der.¹⁶⁴ They vigorously argue that Section 254 permits a scheme in which ISPs benefit from the USF while not having to contribute to the USF.¹⁶⁵

In contrast, the crux of the AT&T camp's argument is that Section 254 does not allow ISPs to take from the fund, but fairness dictates that ISPs should contribute to the extent that they compete with traditional telecommunications carriers.¹⁶⁶ As set forth below, both interpretations are wrong

VI. THE ONLY ACCEPTABLE INTERPRETATIONS OF SECTION 254

There are only two statutorily palatable interpretations of Section 254 as it relates to ISPs. The logical outcome of either interpretation depends entirely upon the regulatory definitions the FCC chooses to apply. Under the first option, the Commission can continue to distinguish between telecommunications carriers, who are classified as offering a telecommunications service and ISPs, who are classified as offering an information service.¹⁶⁷ Option 1 produces a lukewarm result that does little to further Congress' goal of bringing advanced services to schools and libraries.¹⁶⁸

Under option 2, the current distinction between telecommunications carriers and ISPs is dropped.¹⁶⁹ It sheds the constraints of the FCC's second generation basic/enhanced distinction

adopted competitive neutrality as a principle of universal service, the Commission under its Section 254 obligations should create rules that operate in a competitively neutral manner. To maintain rules that are not competitively neutral conflicts with Congress' admonition in Section 254 to adopt universal service policies that reflect the principles enumerated in the statute." See, e.g., Comments of Bell South, *In re Federal-State Joint Board on Universal Service* (Report to Congress) CC Dkt. No. 96-45, at 9 (Jan. 1998) [hereinafter *BellSouth Comments*].

¹⁶⁴ See *AOL Comments*, *supra* note 14, at 18 (supporting the FCC's universal service scheme as consistent with the 1996 Act).

¹⁶⁵ See *id.* at 20-21.

¹⁶⁶ See *AT&T Reply Comments*, *supra* note 7, at 13 (asserting that, "to the extent that a provider offers both telecommunications and information services, the telecommunications portion must be assessed USF support obligations").

¹⁶⁷ See *Universal Service Order* 12 FCC Rcd., at 8822 para. 83; see also *Computer II*, 77 F.C.C. 2d, at 387 para 5.

¹⁶⁸ See 47 U.S.C. § 254 (b)(6); see also 142 CONG. REC. H1113 (daily ed. Jan. 31, 1996).

¹⁶⁹ Senators Burns and Stevens advocate dropping the telecommunications carrier/ISP distinction. See *Burns and Stevens Comments*, *supra* note 20, at 8.

¹⁷⁰ This is precisely the type of broad definition that Senators Burns and Stevens recommend. See *Burns and Stevens Comments*, *supra* note 20, at 5.

and adopts a much broader definition of the term "telecommunications service."¹⁷⁰ A broad definition of telecommunications service that encompasses both traditional basic service and Internet service appears to be supported by the language of the 1996 Act.¹⁷¹ The result of option 2 is more in tune with Congress' intent when it enacted Section 254.¹⁷²

A. Neither the AT&T Camp nor the AOL Camp Can Have Their Way: Option 1

If the FCC continues to distinguish between ISPs and telecommunications providers, neither the AT&T camp nor the AOL camp interpretation of Section 254 can stand.¹⁷³ This, of course, means that the Commission must revisit the decision it made in the *Universal Service Order*.

To date, ISPs are defined by the Commission as providers of information services.¹⁷⁴ Section 254(e) clearly states that only telecommunications providers are eligible for USF support.¹⁷⁵ So long as Internet access constitutes an information service, ISPs cannot be supported by the USF.¹⁷⁶ Combining the Commission's generic authority under section 4(i)¹⁷⁷ with the hazy policy goal elicited in Section 254(h)(2)(a)¹⁷⁸ does not sufficiently justify overcoming the crystal clear man-

¹⁷¹ See *id.*; The Senators point out that there would have been no need to include the definition of 'telecommunications carrier' in the 1996 act if Congress merely intended that definition to mirror the second generation of 'common carrier' which was limited to the providers of basic services. See *id.* at 5.

¹⁷² Otherwise, Congress's referrals to Internet access in the Conference Agreement would have been entirely superfluous. See 142 CONG. REC. H1113 (daily ed. Jan. 31, 1996); but see *McCain: No Common Carrier Regulation for ISPs*, *Multimedia Daily*, Mar. 17, 1998, 1998 WL 6568980 (arguing that Congress never intended for ISPs to be brought under the veil of common carrier regulation, which would be precisely the case if ISPs were considered telecommunications carriers).

¹⁷³ See *Burns and Stevens Comments*, *supra* note 20, at 14.

¹⁷⁴ See *Universal Service Order*, 12 FCC Rcd., at 9180 at para. 789. The Commission reveals the telecommunications carrier/ISP distinction by noting: "We observe that ISPs alter the format of information through computer processing applications such as protocol conversion and interaction with stored data, while the statutory definition of telecommunications only includes transmissions that *do not* alter the form or content of the information sent" (emphasis added). *Id.*

¹⁷⁵ See 47 U.S.C. § 254(e) (Supp. 1997).

¹⁷⁶ See *Burns and Stevens Comments*, *supra* note 20, at 9.

¹⁷⁷ See 47 U.S.C. § 154(i) (1994).

¹⁷⁸ See *id.* at (h)(2)(A).

date of Section 254(e).¹⁷⁹ The FCC cannot simply pile statutory ambiguity upon statutory ambiguity until it achieves the desired result, especially in the face of explicit statutory language.¹⁸⁰

Similarly, because ISPs are classified as information service providers, they cannot be made to contribute to the USF.¹⁸¹ Like 254(e), the language of 254(d) is quite clear.¹⁸² Only "telecommunications carriers" are required to contribute to the fund.¹⁸³ Even in light of the AT&T camp's strong arguments regarding competitive neutrality, there is simply no way to bring an ISP, as currently defined, into the ambit of Section 254(d). A realistic reading of Section 254 demonstrates that, under the FCC's current regulatory framework, ISPs can neither take from, nor contribute to, the USF.¹⁸⁴ Both the AOL camp and the AT&T camp lose out.

B. Dropping the Telecommunications Carrier/ISP Distinction: Option 2 (A Third Generation Interpretation)

Surely in light of the legislative history, option 1 is a bit sour.¹⁸⁵ Why would Congress have even bothered with including a section that discussed advanced services for schools¹⁸⁶ if language within the very same section prohibited the formulation of mechanisms to support those services?¹⁸⁷

There is yet another outcome that the language of Section 254 can bear. This outcome, in fact, is probably more in tune with Congress' intent in enacting Section 254.¹⁸⁸ It requires a revamping

of the FCC's outmode second generation terminology in a way that allows Internet access to constitute a telecommunications service and ISPs to be considered telecommunications carriers.¹⁸⁹

There is support for a broader definition of telecommunications carrier both in the Act and in recent comments made by Senators Burns and Stevens.¹⁹⁰ "Telecommunications carrier" is a third generation term added to the 1996 Act.¹⁹¹ It was not meant to be limited to the FCC's second generation definition of "common carrier," a provider primarily of basic telephone services.¹⁹² As Senators Burns and Stevens point out:

If Congress had intended the term "telecommunications carrier" to mean "common carrier," there would have been no need to add this new term. Congress, though, did intend "telecommunications carrier" to define a class broader than the pre-Telecommunications Act "common carrier" regime. That intent is evident from the definition of a "telecommunications carrier" added by the Telecommunications Act.¹⁹³

Applying third generation terminology, an ISP can justifiably be considered a telecommunications carrier.¹⁹⁴ According to the 1996 Act, "telecommunication" means "the transmission between or among points specified by the user, of information of the user's choosing, without change in the form or content of the information as sent and received."¹⁹⁵ Indeed, when one uses their ISP to access a web page on the Internet or to send an e-mail, information of the user's choosing is being transmitted among and between points specified by the user.¹⁹⁶ Telecommunications have taken place. If Internet service consti-

¹⁷⁹ See *id.* at (e).

¹⁸⁰ See generally *Chevron v. Natural Resources Defense Council*, 467 U.S. 837 (1984) (holding that courts review an agency's construction of a statute with two questions in mind: first, the court must ask whether Congress has spoken directly to the precise question at issue; second, if the statute is silent or ambiguous with respect to the issue at hand, the court must determine whether the agency's interpretation is based on a permissible construction of the statute).

¹⁸¹ See *AOL Comments*, *supra* note 14, at 21; see also *Universal Service Order*, 12 FCC Rcd., at 9180 para. 789.

¹⁸² See 47 U.S.C. § 254(d),(e).

¹⁸³ *Id.* § 254(d).

¹⁸⁴ See *Burns and Stevens Comments*, *supra* note 20, at 12. Indeed, the Senators assert that, "[h]ad the Commission concluded, as we believe they should have, that Internet access is a telecommunications service, then there would be no reason for the Commission's strained interpretation of Section 254(h)(2)(A)." *Id.*

¹⁸⁵ See *Burns and Stevens Comments*, *supra* note 20, at 12 (arguing that Congress intended for schools to receive subsidized Internet access under the fund); see also H.R. CONF. REP. NO 104-458 (1996), *reprinted in* 142 CONG. REC. H1112-

13 (daily ed. Jan. 31, 1996).

¹⁸⁶ See 47 U.S.C. § 254(b)(6) (Supp. 1997).

¹⁸⁷ See *id.* at (e).

¹⁸⁸ See generally *Burns and Stevens Comments*, *supra* note 20.

¹⁸⁹ See *id.* at 12.

¹⁹⁰ See generally *id.*

¹⁹¹ The 1996 Act defines a "telecommunications carrier" as ". . . any provider of telecommunications services." 47 U.S.C. § 153(44) (Supp. 1997). Accordingly, "telecommunications" means "the transmission, between or among points specified by the user, of information of the user's choosing, without change in the form or content of the information as sent and received." 47 U.S.C. § 153(43) (Supp. 1997).

¹⁹² See *Burns and Stevens Comments*, *supra* note 20, at 5; see also *Computer II*, 77 F.C.C. 2d, at 387 para. 5.

¹⁹³ See *Burns and Stevens Comments*, *supra* note 20, at 5.

¹⁹⁴ Designating ISPs as telecommunications carriers may also make ISPs susceptible to the payment of access charges. These implications go beyond the scope of this paper.

¹⁹⁵ 47 U.S.C. § 153(43) (Supp. 1997).

¹⁹⁶ Some protocol conversion does take place when a message is transmitted between two computers in order to enable the transmission. As technologies advance, this sort

tutes a telecommunications service, then ISPs must logically be telecommunications carriers.¹⁹⁷

Under a third generation application, ISPs fit comfortably within the larger category of telecommunications carriers. In applying third generation terminology to Section 254, option 2 achieves a far more amicable result than that of option 1. Accordingly, it is necessary to reinterpret the statute using the new terms.

As newly defined telecommunications carriers, ISPs could receive universal service support for discounted Internet access.¹⁹⁸ The FCC would no longer have to side step the language of 254(e) which limits the beneficiaries of universal service to telecommunications carriers.¹⁹⁹ However, under 254(d), ISPs would also have to contribute to the fund as regular telecommunications carriers.²⁰⁰ Having ISPs both benefit from, and contribute to, the USF will satisfy the 1996 Act's dual goals of bringing advanced telecommunications service to schools and libraries, and maintaining competitive neutrality in a third generation regulatory context.²⁰¹

of conversion will also take place between two phone or two fax machines. This type of conversion, as the Senators point out, is not determinative of a provider's status. Thus, mere peripheral protocol conversion should not lock a service into the Act's definition of an information service. If this were to be done consistently, all services would eventually be deemed "information services" because all communications technologies will eventually incorporate some form of protocol conversion. See *Burns and Stevens Comments, supra* note 20, at 6.

¹⁹⁷ See *id.* at 12.

¹⁹⁸ As a telecommunications carrier, an ISP would come under the guise of subsection (e). See 47 U.S.C. § 254 (e)

VII. CONCLUSION

The current controversy over ISPs and the USF is a result of the FCC's misapplication of second generation regulatory terms to a statute that is supposed to embody the third generation of universal service policy. The Commission cannot allow ISPs to have their cake and eat it too under Section 254. No matter what interpretation the FCC applies, the language of the statute does not allow for ISPs to take from, but not contribute to, the USF.

The FCC needs to re-evaluate its *Universal Service Order*. In doing so, it should do away with the telecommunications carrier/ISP distinction and embrace the broader definition of a telecommunications service that the Act requires. A third generation statute should be interpreted using third generation terminology. Otherwise, the laudable new goals of third generation universal service policy will be sacrificed.

(Supp. 1997).

¹⁹⁹ See 47 U.S.C. § 254(e) (Supp. 1997).

²⁰⁰ The subsection specifically states, "all telecommunications carriers." *Id.* § 254(e).

²⁰¹ It should be noted, however, that reclassifying ISPs as telecommunications carriers will only satisfy the dual goals of competitive neutrality and subsidized Internet access within the Commission's overall universal service plan. Whether universal service itself is compatible with competitive neutrality and a deregulatory environment has yet to be demonstrated. See, e.g., West, *supra* note 2.

