CALIFORNIA PASSES A NET NEUTRALITY STATUTE, CHALLENGING TRUMP ADMINISTRATION FEDERAL POLICY AND REPEAL

October 2, 2018

I. Executive Summary. On September 30, 2018, the State of California passed a "Net Neutrality" statute, intended to counteract the June 11, 2018 repeal by the Federal Communications Commission ("FCC"), the U.S. communications regulatory agency, of 2015 federal Net Neutrality rules promulgated during the Obama administration. While the California Net Neutrality measure is not the first such state law (Oregon, Vermont, and Washington State have also passed laws), it is the first to require protections equivalent to the repealed federal rules that it is intended to replace. The U.S. Department of Justice ("DoJ") immediately filed suit in the federal court for the Eastern District of California, claiming that the state law was preempted because it infringed on a domain reserved to exclusive federal jurisdiction under the U.S. Constitution's interstate commerce clause.

The Net Neutrality debate has huge and ongoing ramifications for merger and acquisition ("M&A") and investment activity, commercial activity, and non-commercial use of the Internet on both sides of that debate: for the telecommunications and cable providers of the Internet "backbone" network, which are opposed to Net Neutrality regulation; and for large institutional providers of content, services, and other users, including smaller service and content providers and end user consumers of that backbone, which are generally in favor of Net Neutrality regulation.

II. Background. In the 1960's and 1970's, the FCC examined the convergence of telecommunications and computer technology in a series of administrative proceedings called the "Computer Inquiries." In these proceedings, the FCC distinguished between communications services in which information was transmitted unaltered, as was the case for simple telephone calls, and data processing services, in which information was stored, altered, or retrieved before, after, or during transmission. The former were called "Communications Services," or "Basic Services," and were regulated under Title II of the 1934 Communications Act (the "1934 Act") as a "common carrier" service, in which the carrier was forbidden to discriminate among users, charge different prices for the same service, or in any way to prefer one kind of traffic to another. The classic paradigm of a "Basic Service," subject to Title II common carrier regulation, was a simple, point-to-point, analog voice telephone call. By contrast, data processing services, called "Enhanced Services," were not subject to common carrier regulation.

The 1996 Telecommunications Act (the "1996 Act"), an amendment and updating of the 1934 Act, preserved the distinction, calling Basic Services "Telecommunications Service," subject to Title II common

carrier regulation, and Enhanced Services "Information Services," which were not regulated as common carrier services. Ironically, the drafting, committee reporting, passage and enactment of the 1996 Act preceded by no more than a year or two the emergence of the Internet and the World Wide Web as a revolutionary mass market medium of communications, information storage, and information dissemination, and for that reason the 1996 Act takes little notice of the Internet, and was fundamentally obsolete from the day it became law.

In response to the Internet's rapid rise, the FCC, lacking adequate legal authority and tools, attempted to regulate the Internet as Information Service, not subject to any meaningful regulation, and in keeping with the general deregulatory bias of the late 1990's and early 2000's. In 2005, the U.S. Supreme Court, in a case called *National Cable and Telecommunications Association v. Brand X Internet Services*, supported the FCC's interpretation, denying that cable television operators, part of the owners and operators of the network through which Internet traffic passed, the so-called Internet backbone, had to open their cable modem Internet service to competitors.

However, during this period, the network owners and operators, themselves busy consolidating, did not really discriminate among users of the backbone; in effect, they more or less self-regulated, and often acted in a generally non-discriminatory manner. The rise of large telecommunications and cable operator providers of the Internet backbone (Internet Service Providers, or "ISPs"), like AT&T, Comcast, Charter, and Verizon; and of large content, service, and application ("app") providers and other users of the backbone, such as Google/YouTube, Amazon, and Facebook, kept the issue alive and fueled an ongoing debate in Congress and the FCC as to whether rules to protect use of the Internet were needed. The term "Net (for "network," not "Internet") Neutrality" emerged as a catchword for proponents of the imposition of rules favoring the content providers'/users' position of common carrier-like, non-discriminatory, service. At the heart of the Net Neutrality debate, which has also spilled into the wireless world, are opposing visions of the Internet as a vital resource in the nature of a public utility, like electricity; or a private, proprietary network that users should expect to pay for at whatever rate the market will bear.

A series of regulatory proceedings and court challenges resulted in the Obama era's March 2015 FCC rules enshrining Net Neutrality (the "Open Internet Order"), effectively reversing the FCC's historic position and treating Internet and broadband service as a common carrier like-public utility, as "Telecommunications Service," rather than as "Information Service." Notwithstanding the common carrier paradigm applied, the Open Internet Order rules stopped well short of imposing all of Title II regulation on ISPs. Over 700 Title II rules were not applied. The Open Internet Order instead focused on three principal rules to preserve Net Neutrality: a prohibition on "blocking" Internet traffic (imposing on content and apps providers so-called

access fees for access to end users), a prohibition on "throttling" (intentionally degrading or impairing Web traffic so as to impose discriminatory and unreasonable fees on providers that connect users to other ISPs), and a prohibition on "paid prioritization" (managing the network to favor some third party Internet traffic – presumably those paying premium pricing – over other third party traffic). In all cases, the Open Internet Order gave ISPs some wiggle room to create anti-net neutrality effects in the course of "reasonable network management."

When the Trump administration came into office in early 2017, one of the FCC's chief stated goals under new chair Ajit Pai was the repeal of the Open Internet Order's Net Neutrality rules. This was accomplished by a December 2017 decision that took effect on June 11, 2018 in the form of the so-called "Restoring Internet Freedom Order."

III. The California Law. The California law, SB 822 (the "Act"), provides consumers with the same range of net neutrality protections as the 2015 Open Internet Order rules, and in some respects goes beyond them. The Act specifically matches the Open Internet Order's 300 pages of specific rules, in a granular attempt by California legislators to close potential loopholes and forestall years of litigation by ISPs and their lobbyists that more broadly drafted "principles"-like provisions would bring. The Act, like the 2015 rules, prohibits blocking, throttling, and paid prioritization.

But the Act goes further than the 2015 Open Internet Order in prohibiting interconnection charges to be charged to a competitor when data on its network enters the ISP's network. The Act also prohibits so-called "zero rating" programs, in which ISPs incentivize the use of their own services and apps over those of competitors by offering free use, without it counting against data limits, while charging fees for the services and apps of competitors (for example, if an ISP like AT&T allowed unlimited streaming of video service Hulu, without it counting against data limits, but not of competitor Netflix). The Act prohibits zero rating unless the ISP exempts from data limits an entire category of service, like streaming video or texting; in other words, both Hulu and Netflix, or neither.

IV. Conclusions. The vigor of California and other states' responses gives some reason to think that Net Neutrality is not dead. California's aggressive stance of state legislation to provide more European Union-style protections for consumers and protected classes of persons has shown up in the California Consumer Privacy Act, enacted on June 28, 2018, and its law requiring women on corporate boards of directors, also enacted on September 30, 2018 (see Kurtin PLLC advisory "California Leads the Way on Gender Bias in Corporate Governance Reform," October 1, 2018). California is the largest U.S. state by population, and would be the world's fifth largest free-standing economy, were it again to declare its

independence. Its legislation in a wide range of areas has become enormously influential as a kind of "thought leader," and other states may be expected to use the Act as a model for their own Net Neutrality legislation; New York and New Mexico are already working on draft bills. In addition, many state attorneys general are challenging the FCC repeal of the Open Internet Order in court.

In many of the post-1996 Act local competition proceedings, the U.S. Court of Appeals for the D.C. Circuit, in particular, was hostile to an expansive view of the FCC's jurisdiction based on the interstate commerce clause. It is also ironic to see the Trump administration DoJ aggressively trying to invalidate state law based on the commerce clause; the tendency of Republican administrations and conservative-leaning courts has been to restrict the interstate commerce federal power in favor of states' rights. Nevertheless, the DoJ has a substantive point: Internet traffic IS fundamentally interstate; even a broadband connection between a California-based ISP and a California-based end user almost certainly at some wireline or wireless network node passes outside of the state. Moreover, since the 1996 Act, law and regulation have treated Internet service as intrinsically interstate, and subject to exclusive federal jurisdiction, preempting state action.

The ramifications, though, are enormous. The meteoric rise of the Internet in little more than twenty years as a medium of mass communication, information dissemination, and information storage has transformed everyday life as well as commerce at every level. In no small measure, that has been due to the "free," non-discriminatory Internet. If Net Neutrality is the paradigm, the M&A, investment, and stock values of the ISPs – the AT&Ts, Comcasts, Charters, and Verizons of the world - is presumably impaired, as they will not be able to charge premiums and discriminate against competitors, reducing revenues, profits, and return on investment. Their use of stock as currency is impaired, and they have to sell more of the company to raise a given amount of capital. Fewer investors may want to buy their stock, and will want to pay less for it, or impose other conditions, if they do. By comparison, in a Net Neutrality world, the corresponding values of the content, services, and apps providers - the Google/YouTubes, Amazons, and Facebooks of the world - is enhanced; they do not have to pay extra for their heavy use of the backbone network. Their stock, both as an investment and as acquisition currency, is worth more.

Also, in a Net Neutrality world, the barriers to entry of an Internet-based business are much lower, and it is easier for startups to gain a foothold. Venture capital and other private equity financing is impacted by Net Neutrality, too: in a Net Neutrality world, the business plan and financial projections of a given early stage business may be far more favorable, yield a different return on investment profile, one more

favorable to the investment decision, or the amount invested, or the terms and conditions of that investment.

By contrast, in a non-Net Neutrality economy, the value of ISPs is presumably enhanced at the expense of the content providers, with similar impacts, but in mirror image to the players in the Net Neutrality economy. Moreover, in the M&A context, a regulatory authority like the FCC or DoJ, or a state public utility commission, might condition transaction approval on Net Neutrality-like guarantees of non-discriminatory access by the post-transaction, successor business enterprise.

In other words, the stakes are enormous and pervasive. The Net Neutrality wars may be playing out for years to come.

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