

BROADBAND DEVELOPMENT:
NEW ENTRY & FINANCING ISSUES

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Introduction:

Broadband development in the United States is gradually being recognized as a critical element in sound long-term economic development as well as a necessity in the conduct of nearly all affairs of life. A major transition is taking place in the broadband industry as attention shifts from providing basic broadband access through DSL, cable modem, wireless/WiFi or satellite services to providing “big” broadband. Infrastructure support for providing big broadband leads to the necessity of building fiber to the premise/home networks. The crucial requirement for this step is to bring the needed investment capital to broadband development in a timely and profitable way. It is interesting to note that Minnesota has seventeen fiber to the premise networks of varying size and in scattered locations, many of them projects of a local telephone company which is also a cooperative, with an occasional municipal telecommunications utility or private fiber to the home project. (www.fiberfirstmn.org)

At the national level, the two telecommunications giants of Verizon and AT&T have recently begun to shift investment capital into fiber to the premises projects. The most promising economics of providing service over fiber requires delivery of multiple services—voice, video and data at least. The commitment of major telecommunications players to the FTTP field has accelerated the pace of growth, sharpened competition between major providers of multiple services and heightened pressure on the policy rules of the game.

Two hotly contested policy areas are policy on video franchise and policy on the entry of municipalities as providers of telecommunications services. In regard to video franchise policy the major change being sought by the big telephone companies is to remove most of the power over franchise terms and conditions from the local level to the national level. The net result under the bills with greatest support in Congress would be a streamlined grant of franchise right to deliver services most likely handled by the FCC with fewer local obligations. (“Communications Opportunity Promotion and Enhancement Act” (H.R. 5252) and “Communications, Consumer’s Choice and Broadband Deployment Act” (S. 2886). At the same time a handful of states have authorized franchising at the state level. These may or may not be preempted by any possible federal legislation.

The policy area of primary concern in this policy paper is that dealing with the entry of municipalities as providers of telecommunications services. Municipalities have been important participants in the provision of utilities of various kinds to their communities. In those areas where both private and public providers of utilities services operate relations have sometimes been tense. Telecommunications services are not likely to be an exception.

Part I:

This review summarizes some key issues arising from municipal entry to telecommunications and information services. For varied reasons a significant number of municipalities across the country have entered some form of service provision and many more are actively exploring the possibility of municipal entry to provide one or more of the three major services—voice, video and data.

The major driver for this activity relates to the perceived central importance of broadband access rather than arising from a specific motive to provide voice or video services. Therefore a significant proportion of the municipal entry activity focuses on data services especially through wireless networks. But other communities aim to provide voice, video and data services either through fiber networks or hybrid fiber coax networks on the grounds of long-term economic development investment.

This is happening for varied reasons including the following:

- a. Perception that robust broadband access will spur economic development and that most communities—especially those outside major urban conurbations—will not enjoy timely deployment from the private sector.
- b. Perception that robust broadband access is vital to quality of life and is referred to more and more as a feature of municipal infrastructure.
- c. Perception that broadband access for all at an advantageous price point is more likely with municipal entry.
- d. Perception that municipal entry with successful service offerings will lead to direct reinvestment in the community.
- e. Perception that competition from municipal providers will spur existing providers to lower prices and improve quality of service.

In the total picture of telecommunications deployment and services the municipal sector is quite small. Nevertheless sharp controversy surrounds the municipal movement into telecommunications and information services. Existing providers have sought legislative prohibition or limitation of conditions of entry at both federal and state levels. Municipalities in turn have sought protection for their right to enter service provision.

This review will analyze the following matters relating to municipal entry:

1. Pending federal legislation
2. Federal legal bases for municipal provision of services
3. State laws and regulatory policy pertaining to municipal entry
4. City authority for telecommunications projects in Minnesota
5. Investment and finance issues for telecommunications projects

Part II: Pending Federal Legislation:

The number and scope of the pieces of pending legislation either protecting or forbidding municipal entry for the provision of telecommunications services indicates a high level of activity that in turn reflects two things. First, there is an increasingly sharp profile of direct competition and this competition is carried out in the legislative arenas between the telephony and cable industries so vacations for lobbyists will be longer and more luxurious this year. Second, local entities and public utilities forces have joined together for an exceedingly strong lobbying effort on their side. Most observers do not expect action on a completed bill in this congressional session.

Pending Legislation:

a. The Barton bill known as the “Communications Opportunity Promotion and Enhancement Act” (H.R. 5252) passed the House on June 8, 2006. Title IV of the bill provides, in one sweeping clause, that state and local entities may provide any telecommunications information or cable service. It is a sweeping bill and the majority of its other provisions are primarily aimed at reshaping the cable franchise process by authorizing the granting of franchises for provision of telecommunications services at the federal level thus dramatically reducing the role for municipal authorities in the franchise process.

b. The Lautenberg-McCain “Community Broadband Act of 2005” (S.1294) focuses on amendment of the 1996 Telecom Act with the claimed intent to preserve and protect the ability of local government to provide broadband capability and services.

c. The “Preserving Innovation in Telecommunications” bill (H..R. 2726) was introduced by Rep. Pete Sessions. The bill sharply limits municipal governments from offering telecommunications, information or cable services except to correct market failures by private enterprise to provide such services.

d. The “Broadband Investment and Consumer Choice Act.” (S 1504) introduced by Senator John Ensign sets out fairly significant limits on municipal entry under the theory that municipalities engaging in provision of telecommunications, cable or video services enjoy unfair advantages.

e. The Senate Commerce Committee will vote on June 22, 2006, on a broad rewrite of the 1996 Telecommunications Act. Sen. Ted Stevens is the chief author and the bill is called the “Communications, Consumer’s Choice and Broadband Deployment Act” (S. 2886) It contains a broad authorization for municipal governments to run their own broadband networks. The bill would apparently override state laws that prohibit municipal entry.

Part III: Legal Bases for Municipal Provision of Services:

The legal authority at the federal level for municipalities to provide communications services have been encouraging but not explicit. Each service that municipalities might wish to provide is separately defined including telecommunications service, cable service information service and broadband service.

Telecommunications Services:

Under 47 U.S.C §3(46) the term telecommunications means “the offering of telecommunications for a fee directly to the public, or to such classes of users as to be effectively available directly to the public, regardless of the facilities used.” Under 47 U.S.C § 3(43) “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.” Further Section 253(a) of the Telecommunications Act of 1996 states that “No state or local statute or regulation or other state or legal requirement may prohibit or have the effect of prohibiting the ability of any entity to provide any interstate or intrastate telecommunications service.”

Recent case findings have limited the meaning of “any entity.” In *Public Utility Commission of Texas, 1997 WL 603179 (October 1, 1997)* the FCC interpreted the term “any entity” to exclude municipalities as such. Texas adopted a prohibition on municipal telecommunications activities and the FCC found that this action by Texas was within the scope of state sovereignty of a “traditional” kind that Congress did not intend to disturb absent a clear indication of intent. The FCC did not find such intent. (Plain statement standard stated in *Gregory v. Ashcroft, 501 U. S. 452, 461 (1991)*).

Other subsequent cases including *City of Abilene v. FCC, 164 F.3rd 49,54 (D.C. Cir. 1999)* followed this reasoning. A contrary finding emerged from the 8th Circuit in *Missouri Municipal League v. FCC, 299 949 (8th Cir.2002)* arguing that municipalities have traditionally been viewed as entities and that the term “any” was meant to be applied broadly.

Finally in 2004 the *Supreme Court in Jeremiah W (Jay) Nixon v. Missouri Municipal League, 541, U. S. 125,124 S. CT 1555, 2004 U. S. LEXIS 2377(2004)* decided against the 8th Circuit interpretation on the grounds that the Congress had not clearly enough indicated its intent to preempt state authority. The Court took pains to indicate that it was not pronouncing on the merits of municipal entry.

Cable Services:

Disputes over the ability of municipalities to provide cable services have been more muted than in the area of telecommunications. Section 613(e) of the Communications Act, 47 U.S.C. §533 (3) provides” (1) Subject to paragraph (2), a State or franchising authority may hold any ownership interest in any cable system and (2) Any State or franchising authority shall not exercise any editorial control regarding the content of any cable service on a cable system in which such governmental entity holds ownership interest (other than programming on any channel designated for educational or governmental use, unless such control is exercised through an entity separate from the franchising authority.” While one court has found this language permissive rather than empowering others have interpreted Section 613 as authorizing entry.

The definition of “information services” has played a key role in insulating the cable industry’s cable modem service for provision of Internet services from being regulated as a telecommunications service subject to common carrier expectations. In particular the ability of the cable industry to successfully argue that its cable modem service was distinguishable from telephony based Internet access via DSL has helped encourage investment and expansion in this service. The Communications Act defines the term “information service” as “the offering of a capability for generating, acquiring, storing, transforming, processing, retrieving, utilizing or making available information via telecommunications, and includes electronic publishing, but does not include any use of any such capability for the management, control or operation of a telecommunications system or the management of a telecommunication service. 47 U.S.C. § 320).

Information Services:

Information services relate most closely to the policy goal at the federal level to encourage broadband or advanced telecommunication services particularly in rural, insular or high cost areas. Section 706(a) of the 1996 Telecommunications Act identifies a duty for the FCC and the States to encourage the deployment on a reasonable and timely basis advanced telecommunications capability to all but it does not identify specific steps except in Section 706(b) which calls for the FCC to evaluate progress annually and if found lacking to accelerate deployment by removing barriers to investment and by promoting competition in the telecommunications market.

Part IV: State laws and Regulatory Policy Relating to Municipal Entry:

In the last decade states has been a hotbed of activity with both the telecommunications and the cable the industries devoting significant resources to erecting barriers to entry by municipalities. In turn, municipal entities and public utilities have resisted such efforts. However, there is no single, simple barrier that is common across all states. Whatever the form of barrier enacted. all are affected by the context provided under “Dillon’s Rule” and under “home rule” status.

“Dillon’s Rule” directs that the authority of a municipality be strictly construed to include only explicit powers granted in the state’s constitution of legislature unless necessarily implied or incidental or express powers. The rule may be codified or judge made and where the rule exists, silence is generally construed against the municipality. And if a government entity is a Dillon’s Rule state, then any communications activity must be a reasonable extension of an already granted power.

In “Home Rule” states, “home rule” or “charter cities” usually are able to exercise any powers, and perform any functions, that are not expressly denied by the state’s constitution or statutes or by the municipality’s own Home Rule charter. This makes “charter city” status much more autonomous than non “charter city” municipalities. However, the applicability of the Rule must be examined to see whether it applies to all entities related to the city or to all situations involving the city

Looking across states it is apparent that some states have expressly granted local governments authority to provide communications services (California, Oregon, Arizona) whilst others expressly forbade it (Texas, Arkansas, Nevada). Some states give authorization to provide some services but not others (Washington). Still others have put up measures that impose high burdens that act as effective barriers to entry (Minnesota). In the last two years especially a new breed of legislation has appeared which lays down procedures and acceptable process for getting into and running the business. In order to implement the new legislation powers are lodged with the state public service commissioners to oversee the new requirements of the law.

The following states have enacted some flavor of barrier to municipal entry. Should any one of the provisions giving sweeping authority to municipalities to enter communications services now written into pending legislation succeed in becoming law it would have a major impact on barriers to entry in numerous states.

- Arkansas
- Florida
- Louisiana
- Minnesota
- Missouri
- Nebraska
- Nevada
- Pennsylvania
- South Carolina
- Texas
- Utah
- Virginia
- Washington
- Wisconsin

PART IV: CITY AUTHORITY FOR TELECOMMUNICATIONS PROJECTS IN MINNESOTA

Minnesota cities are not explicitly authorized to enter into provision of telecommunications services or to form a telecommunications utility. Nevertheless, some Minnesota cities have built and are operating municipal telecommunications systems. These cities have concluded that there is implied or inherent municipal authority to construct such infrastructure. Cities are generally authorized to acquire property for purposes defined by the city's requirements and to manage and control that property as its interests require (Minn. Stat. §412.211). However, at this point there is no case law or other authority on point.

In addition to whatever cities might believe is possible under implied or inherent authority, the interested city needs to look at other statutory provisions dealing with specific telecommunications services. If a municipality wishes to offer telephone service it is authorized to do so under certain conditions. These conditions include that it can own and operate a telephone exchange within its own borders but it must have a 65% approval vote from the community to do so (Minn. §237.19). This has proven to be a significant obstacle. In Minnesota a "telephone exchange" as defined by the Public Utilities Commission includes a switching facility or central office. Since telephone services can be differently configured it is unclear how Minn. §237.19 might apply, i.e., whether a referendum is required for delivery of differently configured telephone services. In regard to video services, cities are also explicitly authorized to own and operate as a city utility a video (cable) delivery system (Minn. Stat. § 465.70 & Minn. Stat. §238.08 Subd. 3)

If a city wishes to offer Internet service and looks for specific statutory authority some does exist. In 2000 the Minnesota legislature authorized construction of local improvement facilities for "Internet or other communications purposes" subject to the need for certain council findings that the service will not compete with private entities (Minn. § 291.031). The key issue in regard to the ability of a Minnesota municipality to finance the construction and operation of a broadband system for Internet service is determining what constitutes impermissible competition. If a community were to be challenged in its effort, most likely the courts would look to the nature of the service currently offered within the community by the private sector, what types of technologies are considered competitive with one another, and whether all areas of the community are intended to have the new service, among others.

Some Minnesota cities have begun to look toward the general authority to be found in the authority of cities to engage in economic development. Under Minn. Stat. §469.124, 125 and 131 cities may create development districts and under a development program the city has powers to acquire, construct, operate, maintain or promote developments aimed at improving the physical facilities, quality of life and quality of transportation". Economic development authorities have the power to use the proceeds of revenue bonds for economic development facilities that the authority believes will require financing.

Recent studies show a beneficial economic gain in conjunction with provision of broadband which reinforces the argument about the economic development benefits of broadband.¹

PART IV: AUTHORITY, INVESTMENT & FINANCE ISSUES FOR TELECOMMUNICATIONS PROJECTS

With the entry of Verizon and AT&T into the FTTP market, it would appear that increased private equity support for financing FTTP projects will follow. Many unknowns remain in respect to the new growth in private provisioning of FTTP projects. How rapidly can or will other providers follow? Where will fiber projects take place? Will the higher income communities be the main winners of the fiber prize? How do rural places fit into the private sector equation especially non-coop service areas?

Investment and finance issues are central issues also for municipalities whether individual or regionally based projects. Since it is evident from the stir of activity among municipalities that the interest in big broadband is well established it is likely that cities will need to understand more clearly what opportunities and limits exist in Minnesota and elsewhere for investment in telecommunications infrastructure. Looking across the landscape we see municipal projects in Alexandria, Buffalo, Chaska, Detroit Lakes, St. Louis Park, St. Peter and Windom. Others are underway. Only Windom is a municipal fiber to the premises project. This discussion will explore the requirements for funding, examine some of the barriers and consider how options might be increased (as it applies generally to telecommunications entry whether or not for big broadband).

Assuming that the municipality concludes it has the authority to engage in construction and operation or lease of telecommunications facilities the general tools for municipal finance are well known. These include general obligation bonds, annual appropriation lease revenue bonds, revenue bonds. Each carries a different mix of benefits and costs. General obligation bonds (30 years) require a referendum if not being issued for equipment (10 years), taxpayers back them up & they are the least costly to the city. Annual appropriation lease revenue bonds (20 years) have broad legal authority, entity secures, close to general obligation bonds in cost. Revenue bonds (15 years) have statutory authority for enterprise funds, enterprise secures & assumes public ownership, most expensive.

¹ (Kelly, Doris J., "A Study of the Economic and Community Benefits of Cedar Falls, Iowa's Municipal Telecommunications Network," Pub. 10/2/03, Updated 7/6/2004.) Lake County, Florida (Ford, George S. & Koutsky, Thomas, S. "Municipal Broadband Networks and Economic Development: A case Study from Florida." Applied Economic Studies, April, 2003) and a broader study from MIT (Gillett, Sharon E., Lehr, William, Osorio, Carlos & Sirbu, Marvin. "Measuring Broadband's Economic Impact" TPRC, 9/23/05).

Since each city contemplating a municipal system will eventually face the question of appropriate vehicles for financing the project, a policy option might be for cities to find some strength in numbers by joining together to tackle the issue. One initiative might be a common lending facility possibly created under a new legislative authority but funded privately so that each community avoids reinventing the wheel. Or it might come about via the intervention of a public entity organization that has an existing interest in public utilities. An organization that might be appropriate would be the Minnesota Public Utilities Association.

A second initiative that might help make the entry process more understandable might be the purposeful professional involvement of the bond attorney advisory group in helping to clarify the parameters for appropriate vehicles for project finance. Not all bond attorneys are ready individually to venture into the relatively new demands posed when the public purpose involves broadband telecommunications infrastructure and the mix of financing vehicles may be somewhat novel.

This brief overview on authority, investment and finance suggests that the cities may wish to keep in mind some alternatives that might help more clearly confirm the City's scope of authority. It may be useful to seek an opinion from the Minnesota Attorney General's office concerning the relevant issues. An opinion is not binding but is often persuasive in the face of uncertainty. Other possibilities include that a community would decide to hold a referendum even if not required by bonding authority or other statute. If the community were constructing a telephone exchange it would in any case be required. Of course, the currently pending national telecommunications legislation (with the greatest chance of passage) explicitly authorizes municipal entry for telecommunications services and that would materially affect the Minnesota scene.

The most important lesson to be drawn from this discussion is that it may be easier for a municipality to embrace the technology than to find the right way to own and pay for it.