

spotlight

No. 463 – March 2, 2015

THE FCC'S ANTICOMPETITIVE GREENLIGHT

Commission is wrong to override North Carolina law for municipal broadband

KEY FACTS:

- Under the North Carolina Constitution, municipalities are creations of the state legislature, which has constitutional authority over municipal government as well as local taxation and debt.
- The City of Wilson's petition seeks an end-run around these constitutional constraints that would, if granted, allow it to act independently of the legislature that created it.
- In 2009 the John Locke Foundation warned of coming financial problems with the City of Wilson's Greenlight network. Those warnings, unheeded, have proven accurate.
- Other, similar problems have hampered other municipal broadband systems: Salisbury, Morganton, and Mooresville and Davidson.
- Those systems were financed with Certificates of Participation, which don't require voter approval. But local taxpayers are still obligated to fund their operating losses.
- Legislators' concern over these problems led to the passage in 2011 of the Level Playing Field Law. Wilson says the law is anticompetitive.
- Wilson has the idea of competition backward. It's the government entry — guaranteed to have its losses and discounts covered by taxpayers — that brings unfair competition to the market.
- The Level Playing Field law mostly doesn't apply to Greenlight, which is specifically exempted in the statute.
- Where it does apply shows exactly the problems with Wilson getting into the broadband market. Greenlight still needs money and therefore customers, which it cannot attract enough even within the entire county.
- An examination of the provisions in the Level Playing Field law shows that it seeks to protect competition from anticompetitive forces.

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n July 14, 2013, the City of Wilson filed a petition with the Federal Communications Commission (FCC) to preempt North Carolina law as it regards the city’s municipal broadband service. The city alleged that the law prevents it from expanding its broadband service to surrounding areas.

The FCC asked for public comment on the petition. This Spotlight comprises the comments by Jon Sanders, Director of Regulatory Studies for the John Locke Foundation, submitted to the FCC August 29, 2014.

On February 26, 2015, the FCC voted in favor of Wilson’s petition.

**Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554**

In the Matter of)	
)	
City of Wilson, North Carolina)	
Petition for Preemption of)	WCB Docket No. 14-115
North Carolina General Statutes)	
§ 160A-340, et seq.)	
WCB Docket No. 14-115)	

Comments from the John Locke Foundation

These comments are respectfully submitted pursuant to the Public Notice issued July 28, 2014 (DA 14-1072) in the proceeding referenced supra in connection with the City of Wilson, North Carolina’s Petition for Preemption of North Carolina General Statutes §§ 160A-340, et seq.

Introduction

Municipalities in North Carolina are constitutionally the creations of the state legislature, the North Carolina General Assembly. Article VII, Local Government, of the North Carolina Constitution provides that

The General Assembly shall provide for the organization and government and the fixing of boundaries of counties, cities and towns, and other governmental subdivisions, and, except as otherwise prohibited by this Constitution, may give such powers and duties to counties, cities and towns, and other governmental subdivisions as it may deem advisable.¹

As such, the General Assembly has constitutional authority over municipal government. Furthermore, this authority is reinforced over local taxation and debt (see Article V).²

The City of Wilson’s petition seeks an end-run around these constitutional constraints that would, if granted, allow it to act independently of the legislature that created it. It would allow the city to continue to make, as argued below, questionable decisions beyond the reach of voters that nevertheless negatively affect their tax and electricity rates. Such a precedent would create untold fissures in North Carolina government.

As for the competitive concerns behind the petition, as argued below, consumers have a range of private options to choose from. A government entrant that can by virtue of taxing and ratemaking authority insulate its system from losses and full pricing delivers harm, not help, to the competitive environment.

Early warnings of anticompetitive effects and unanticipated negative consequences of the City of Wilson’s Greenlight system

In January 2009, Dr. Michael Sanera and Katie Bethune of the John Locke Foundation, an independent, nonprofit think tank seeking to “transform government through competition, innovation, personal freedom, and personal responsibility” and “a better balance between the public sector and private institutions of family, faith, community, and enterprise,” authored a research paper warning about the potential for anticompetitive effects and unanticipated negative consequences of the City of Wilson’s Greenlight network.

Sanera and Bethune highlighted several aspects of Greenlight:

- The city used about \$28 million in bonds to finance the system, which will be paid over 25 years
- The system expected a first-year operating loss of \$5.6 million
- Annual debt repayment would be \$1.8 million, and overall annual system costs would be about \$7.4 million
- City leaders have stated that increases in electricity rates and property taxes on Wilson residents would be used to repay the debt service if there are not enough subscribers to the Greenlight service to pay for it
- City officials’ expectations of sufficient subscribers to Greenlight derive from a 2006 consultant’s report that its price structure would be 7–13 percent below private-sector competitors’
- Existing private competitors for cable, phone, and Internet subscribers in Wilson include Time Warner, Embarq with Dish Network, DirecTV (cable competitor), and HughesNet (Internet competitor)
- City officials furthermore expected economic-development benefits to the city by Greenlight pricing high-speed broadband far below market levels
- The primary beneficiaries of the system would be large businesses, not homeowners
- Other city-operated cable systems failed (citing Ashland, Oregon; Provo, Utah; and Lebanon, Ohio), resulting in higher property taxes or electricity rates for city residents and then the cities selling the systems
- The 25-year debt financing of the Greenlight system also ignores the threat of rapidly changing technology that could obsolete it, which would leave Wilson taxpayers and ratepayers shouldered with even greater burdens of repayment³

By 2011, with Greenlight’s losses mounting, Wilson had already done as Sanera and Bethune foresaw. It had begun borrowing from its electric and gas funds — \$11 million already by 2011, when the Level Playing Field law was passed, even though Wilson’s electricity and gas rates were already higher than others’.⁴

State law in question was informed by other municipalities' experiences

Salisbury

Sanera and Bethune issued similar warnings to the City of Salisbury, North Carolina, in May 2009 over its Fibrant system.⁵ Their insight was apparently validated this year when Moody's downgraded Salisbury's general obligation bond rating, citing the city's debts by Fibrant. The city had borrowed \$7.6 million from its water and sewer fund to support Fibrant but had no plan to pay back the borrowed funds.⁶

As *Carolina Journal* has reported, there are several private competitors for telecom services within Fibrant's service area: AT&T (including U-verse), Windstream, Time Warner, Dish Network, and DirecTV.⁷

The state law under challenge, Session Law 2011-84 (House Bill 129), the "Level Playing Field" Law, mostly exempts Wilson's Greenlight, Salisbury's Fibrant, and the municipal telecom services of two other North Carolina local governments: Morganton's CoMPAS Cable TV and Mooresville-Davidson's MI Connection while limiting them to their service areas.⁸

In April 2011, while the Level Playing Field law was under discussion, Fibrant was serving only 750 customers and in need of thousands more to become profitable and repay its debt. Officials then had forecast that would happen in four years.⁹

Mooresville and Davidson

In 2007 Mooresville and Davidson borrowed \$92.5 million to purchase and upgrade a bankrupt cable system previously owned by Adelphia Cable, even though a private company, Time Warner Cable, sought to buy it.¹⁰ Davidson's town manager actually used Time Warner's interest as justification for the town's purchase, arguing that "If the system weren't profitable, why would Time-Warner Cable want it?" before stating the "potential growth of customers, and therefore profits, is astronomical."¹¹

The system has posted multimillion-dollar deficits since its purchase. In 2010 officials of both towns were chagrined to learn that the system needed another \$6.4 million subsidy from taxpayers. Part of the scramble to meet these unanticipated costs involved attempts to lobby and even shame citizens into buying the service.¹²

In 2011, when the Level Playing Field law was passed, MI-Connection posted a loss of \$5.6 million, while it had lost \$6.8 million and \$6.4 million the previous two years. MI-Connection board chairman John Venzon told the *Lake Norman Citizen* of August 23, 2012, that his goal was to get the system in a position by 2017 to sell it.¹³

There had been other local governments involved in discussions over purchasing and upgrading the Adelphia system. One of them, the Town of Huntersville, held a vote in 2007 of commissioners over the idea, which resulted in a 3-2 vote in opposition. Then-commissioner Charles Jeter explained his rationale for voting against it this way:

My dilemma was that I didn't think a government entity should be involved in an industry that changes so rapidly. The one thing government does not do well is change and adapt rapidly. Also, we were being asked to make decisions about something we didn't know anything about and, believe me, there was no one in the room who knew the first thing about the industry.¹⁴

Morganton

Morganton has operated the CoMPAS system since 2004 but has had to borrow funds from the municipal electricity and general funds and still owes those funds money.¹⁵ Citizens at a town meeting over the 2013-2014 budget expressed outrage over tax increases and electricity rate increases and cross-subsidization.¹⁶

Certificates of Participation

All of these struggles were known to the North Carolina General Assembly. In 2010 the Revenue Laws Study Committee made an inquiry into the method of debt financing used by those cities for their municipal fiber-optic networks. That method was by Certificates of Participation, which unlike General Obligation bonds are *not subject to a vote of the citizens*.¹⁷

That report noted the following:

All of the cities that currently operate a cable and internet system had an operating loss in their system in fiscal year 2007-08 and 2008-09 ranging from \$128,000 to \$2.6 million. Two of the cities, Morganton and Wilson, have transferred funds from their electric utility public enterprise operations to provide funds to their cable and internet systems. Salisbury has issued \$35.9 million in certificates of participation to finance its system and is in the process of constructing the system.¹⁸

Such negative consequences playing out without even municipal voter (or ratepayer) say were clearly making an impression on the General Assembly.

Of market competition

The apparent rationale for the City of Wilson's request that the Federal Communications Commission overturn the Level Playing Field law is that the law is anticompetitive; i.e., that by limiting Greenlight to a service area of Wilson County, the law prevents Greenlight from competing. This rationale has the idea of competition backward.

A private company cannot legally take money from others involuntarily, whether they are customers and especially if they are not. A private company that cannot stop its losses or cease bleeding money soon ceases to be. A government entrant into the market, however, comes with the guarantee of its losses being borne by taxpayers (or, in some instances here, electricity ratepayers). This guarantee conveys a significant competitive advantage, one that can be leveraged even further to offer heavily discounted rates to serve the government's want for an incentive to offer businesses for economic development purposes.

It was not and is not the case that broadband consumers in Wilson are without options save for Greenlight. As it is, the Level Playing Field law mostly doesn't apply to Greenlight, as it is specifically exempted in the statute. Where the law does apply, however, only serves to underscore the problems with the municipality getting into the broadband market. As evident by its borrowing from other municipal funds, Greenlight still needs customers, and the system apparently cannot attract enough within the entire county.

This situation is, however, a political problem, and not one for the FCC to solve. The solution proposed would serve to make such poor local decision-making more likely, not less. It would therefore be harmful to competition as well as to service consumers and nonconsumers alike through cross-subsidization schemes.

Conclusion

The Level Playing Field law was instituted under the General Assembly's constitutional authority over municipalities with sobering examples from Wilson, Salisbury, Morganton, and Mooresville and Davidson calling their attention to the need to prevent these kinds of problems. It was also, by dint of its provisions, aimed at protecting competition when future municipalities embark on such endeavors.

Among other provisions, it therefore requires future municipal broadband systems to comply with all federal, state, and local laws to which private providers are subject; prevents them from requiring subscribership from individuals or developments; limits their sources of revenue to those generated by the service, not from other services' funds; forbids them from pricing services below cost; disallows municipalities from using non-voter-approved bonds to fund the service; and requires payments in lieu of taxes to counties and the state equivalent to what a private company so situated would be required to pay.¹⁹

Citizens and competition are harmed when municipal officials who, in the words of the circumspect Huntersville commissioner, "don't know the first thing about the industry," nevertheless go into debt financing without voter approval the municipality's entry into the industry, then rely on cross-subsidization to keep the endeavor afloat while pulling some consumers away from private providers and distorting the market.

For those reasons, the Commission should reject the petition.

Respectfully submitted,

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Endnotes

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