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How Municipal Broadband Railroads Due Process

BY LAWRENCE J. SPIWAK

Over the last decade, there has been much debate over whether local governments should get into the broadband business by building their own networks. While most don't view municipal broadband as controversial in rural high-cost areas where it is too expensive for the private sector to enter profitably, it is a very different story when municipalities seek to over-build in established metropolitan areas that are already served by multiple private sector providers. These government-owned networks ("GONs") typically require massive injections of federal, state, and local tax dollars for their construction and operation.

Some city governments have taken to raising taxes, shifting funds between other government services like a city electric utility, or just dipping straight into the city's coffers to cover seemingly perpetual financial shortfalls.

The motivation for the private sector's distaste for such systems is plain enough. Taxpayer subsidies permit the GONs to charge below-cost rates—a type of predatory pricing that is both sanctioned and financed by the government. Competing under such conditions is difficult, at best, for unsubsidized private firms. Municipal entry could very well be a poison pill for private sector investment. Indeed, even the threat of municipal entry makes investors skittish about committing billions of their own money to build Internet networks that would have to compete with uneconomic pricing by a self-subsidized government network. As the FCC recognized in its 2010 National Broadband Plan, "Municipal broadband has risks. Municipally financed service may discourage investment by private companies."

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Making matters worse, as the private sector attempts to compete against City Hall for market share, local governments that operate GONs control many key inputs of production essential for private-sector broadband deployment. (There is a well-documented history of local municipalities taking, to put it politely, a rather recalcitrant posture towards private sector broadband deployment, forcing the Federal Communications Commission to get involved. Fortunately, the courts have generally sided with the Commission.)

For example, if a private firm wants to provide multi-channel delivered video programming over its network, then it must first obtain a cable franchise from the local government. As the FCC recognized, local governments often use this process as a "Christmas Tree" to extract rents from the applicants, including high franchise fees, onerous buildout requirements, and numerous other concessions such as free broadband for city services or mandatory carriage of PEG channels. If a private communications firm wants to put up a cell tower, once again it needs local government approval. Want to use municipal duct works? Same thing. And, in many cases where the municipal broadband provider is also the local municipal electric utility monopoly, if a private firm needs to attach a wire to a utility pole, guess who it has to deal with? Municipalities are known to charge highly inflated rates for pole access. Finally, but certainly not least, the government has the general power to tax, again affecting private sector entry costs. The conflicts of interest abound.

Which brings us, oddly enough, to railroads.

Association of American Railroads A recently released decision by the federal Court of Appeals for the D.C. Circuit in *Association of American Railroads v. U.S. Department of Transportation* addresses the fundamental fairness of the private sector being forced to compete against City Hall. In this case, the plaintiffs argued that the Passenger Rail Investment and Improvement Act of 2008 (PRIIA) violated the Due Process Clause of the Fifth Amendment because it permitted Amtrak effectively to regulate the rates, terms and conditions of key inputs of production required by its competitors. After review, the court agreed.

In the D.C. Circuit's view, the "power to self-interestedly regulate the business of a competitor is . . .

anathema to ‘the very nature of things,’ or rather, to the very nature of governmental function.” As such, Amtrak’s self-interest constitutes “an intolerable and unconstitutional interference with personal liberty and private property” and is “clearly a denial of rights safeguarded by the Due Process Clause of the Fifth Amendment.” (Slip op. at 14.) More to the point, the court found that “government’s increasing reliance on public-private partnerships portends an even more ill-fitting accommodation between the exercise of regulatory power and concerns about fairness and accountability.” (Id. at p. 18.) Thus, concluded the court, “[w]herever Amtrak may fall along the spectrum between public accountability and private self-interest, the ability—if it exists—to co-opt the state’s coercive power to impose a disadvantageous regulatory regime on its market competitors would be problematic.” (Id.)

The defendants responded by arguing that because Amtrak is a government entity, it was not seeking to advance its own private interests because it was forced to comply with a variety of mandatory “public interest” obligations. The D.C. Circuit would have none of it. As the court observed, concluding that Amtrak is not an autonomous private enterprise “is not the same as concluding it is not economically self-interested.” (Id. at p. 19-20.) According to the court,

many corporations are obligated to compromise profit-seeking ambitions pursuant to statutory goals aimed at public goods. Corporations must, for instance, comply with the Americans with Disabilities Act, the Clean Air Act, and the Affordable Care Act, even though doing so may not otherwise have been the most economically prudent choice. Compliance with these statutory directives does not somehow negate economic self-interest. (Id. at p. 20)

Viewing the totality of the circumstances, therefore, the D.C. Circuit concluded that PRIIA violated the Due Process Clause of the Fifth Amendment because Amtrak’s “economic self-interest as it concerns other market participants is undeniable” (id. at p. 21) and, therefore, it was improper for PRIIA to permit Amtrak effectively to regulate the rates, terms and conditions of key inputs of production of its competitors.

Municipal Broadband Providers Are Clearly “Self-Interested Entities” Proponents of municipal broadband will likely seek to distinguish *American Railroads* on the ground that Amtrak is affirmatively charged under its statutory charter with making a profit, while municipal broadband systems are generally organized as not-for-profit entities. Thus, proponents will argue, as municipal networks are not interested in profit but rather the local good, GONs cannot be “self-interested entities” and *American Railroads* does not apply. (For example, FCC Chairman Tom Wheeler argues that “Commercial broadband providers can pick and choose who to serve based on whether there is an economic case for it. On the other hand, [a municipal broadband network] . . . has a duty to ensure that *all* of its citizens have affordable broadband Internet access.”) According to established case law, however, that argument doesn’t hold water.

As the D.C. Circuit in *American Railroads* observed, a traditional government entity is “not self-interested” because “government strives—at least in theory—for an equilibrium of revenues and expenditures, where the revenue obtained is no more and no less than the oper-

ating costs of the services provided.” (Slip op. at 21.) However, like Amtrak, municipal broadband networks hardly fit this description.

GONs are in the business of obtaining market share and are clearly “competing” with private firms to capture customers. (Some GONs have obtained market shares in the 40-60 percent range.) In fact, advocates for municipal broadband point to “increased competition” as a justification for GONs. Thus, regardless of whether GONs are officially not-for-profit entities, it is abundantly clear that they are not, as *American Railroads* held, “presumptively disinterested” participants in the broadband market. (See slip op. at p. 24.) Indeed, because GONs wrestle with private providers for market share, municipal networks’ “economic self-interest as it concerns other market participants is undeniable.” (Id. at p. 21.) Yet while GONs compete against the private sector, these same local governments retain the ability to grant or deny access to key inputs production for the private sector. Municipal providers therefore have the “power to regulate the business . . . of a competitor,” a coercive authority the D.C. Circuit in *American Railroads* found to be “an intolerable and unconstitutional interference with personal liberty and private property” that transgresses “the very nature of governmental function.” (Id. at p. 24).

It should also be noted that the Supreme Court, in *City of Lafayette, Louisiana v. Louisiana Power and Light*, 435 U.S. 389 (1978), similarly rejected this public interest defense when it held that municipalities are not immune from the antitrust laws under the “state action” doctrine of *Parker v. Brown* when they compete directly for customers with the private sector. In *City of Lafayette*, municipalities argued that the antitrust laws are intended to protect the public from abuses of private power and not from utilities “that exist to serve the public weal.” The Court rejected this argument, finding the municipalities’ contention that “their goal is not private profit but public service” to be only “partly correct.” As the Court explained:

Every business enterprise, public or private, operates its business in furtherance of its own goals. In the case of a municipally owned utility, that goal is likely to be, broadly speaking, the benefit of its citizens. But the economic choices made by public corporations in the conduct of their business affairs, designed as they are to assure maximum benefits for the community constituency, are not inherently more likely to comport with the broader interests of national economic well-being than are those of private corporations acting in furtherance of the interests of the organization and its shareholders. The allegations of the counterclaim, which for present purposes we accept as true, aptly illustrate the impact which local governments, acting as providers of services, may have on other individuals and business enterprises with which they inter-relate as purchasers, suppliers, and sometimes, as here, as competitors. 435 U.S. at 403.

While the Court noted that municipal systems “may, and do, participate in and affect the economic life of this Nation in a great number and variety of ways,” the Court held that: “When these bodies act as owners and providers of services, they are fully capable of aggrandizing other economic units with which they interrelate, with the potential of serious distortion of the rational and efficient allocation of resources, and the efficiency of free markets which the regime of competition em-

bodied in the antitrust laws is thought to engender. If municipalities were free to make economic choices counseled solely by their own parochial interests and without regard to their anticompetitive effects, a serious chink in the armor of antitrust protection would be introduced at odds with the comprehensive national policy Congress established.” 435 U.S. at 408.

So even if a city correctly views its actions as being for the “benefit of its citizens,” that does not imply the city is incapable of, or excused from, anticompetitive conduct that may lead to a “serious distortion of the rational and efficient allocation of resources, and the efficiency of free markets.” As the Court observed, “parochial interests” do not nullify “anticompetitive effects.” Under both *City of Lafayette* and *American Railroads*, therefore, municipal networks are clearly “self-interested entities.”

Conclusion If one thinks about it a bit, the gripe against municipal broadband is more than it is just unfair for the private sector to be forced to compete against City Hall; at bottom, the argument is really that it is inherently unfair for the private sector to be forced to compete against a governmental entity that can use its sovereign power to regulate the rates, terms and conditions over key inputs of production required for entry. After all, the power to tax is the power to destroy. With the D.C. Circuit’s ruling in *American Railroads*, a court has formally affirmed that due process of law is violated when a self-interested entity is entrusted with the power to regulate the business of a competitor—even when that self-interested entity is the government. Whether a private broadband provider will choose to bring a case against municipal operators based on this legal theory remains to be seen. Given the cases outlined herein, if one does, then I think there is a good probability of success.