IN THE DISTRICT COURT OF APPEAL
FIRST DISTRICT, STATE OF FLORIDA

DEPARTMENT OF REVENUE,

Appellant,

vs.

CITY OF GAINESVILLE,

Appellee.
_____/

CASE NO. 1D02-1582
L.T. Case No. 00-1292

On Appeal From the Circuit Court for the Second District of Florida

BRIEF OF *AMICUS CURIAE* FLORIDA MUNICIPAL ELECTRIC ASSOCIATION

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BRIEF OF *AMICUS CURIAE* FLORIDA MUNICIPAL ELECTRIC ASSOCIATION[1]

In this brief, the Florida Municipal Electric Association ("FMEA") responds to the policy arguments that the Florida Telecommunications Industry Association ("FTIA") has made in the section of its *amicus* brief entitled "Introduction and Statutory Overview."[2]

The parties and the circuit court below focused on a simple and straightforward issue of law – Whether the Florida legislature violated the Florida Constitution by imposing *ad valorem* taxation on municipal providers of telecommunications services. Now, on behalf of the major incumbent telephone companies operating in Florida,[3] FTIA seeks to inject a new and irrelevant issue

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1 On October 31, 2002, the undersigned attorney for the Florida Municipal Electric Association sent to the Court a Motion for Admission *Pro Hac Vice* and an Unopposed Motion of the Florida Municipal Electric Association for Leave to Participate as *Amicus Curiae.* We have not heard whether the Court has granted the motions, but to be sure of meeting the Court's filing requirements, we are serving this brief today.

2 *Amicus Curiae Brief of the Florida Telecommunications Industry Association* ("FTIA Brief") at 8-14. Elsewhere in its lengthy brief, FTIA essentially mirrors the appellant's arguments on various constitutional, procedural and other issues of Florida law. The City of Gainesville will respond to these arguments.

3 In describing the interests that it seeks to protect by participating as an *amicus curiae,* FTIA states that "The members of the FTIA include most of the major telecommunications companies doing business in Florida. These companies have an interest in the issues in this case because Chapter 97-197, Laws of Florida, directly impacts the conditions under which municipalities can engage in activities in direct competition with members of FTIA." Brief at 2. Later, in discussing whether municipal entry into telecommunications

into this litigation – Whether *ad valorem* taxation on municipal telecommunications providers is necessary to achieve the goals of the federal Telecommunications Act of 1996 and to promote "sound public policy."[4] FMEA submits that FTIA's attempt to distract the Court from the constitutional issue before it is procedurally improper[5] and wrong on the merits.

According to FTIA, the Florida Legislature pursued the same goals as those underlying the Telecommunications Act when it subjected municipalities to the *ad valorem* taxation at issue. FTIA Brief at 8. FTIA also asserts that the Legislature's action promoted "sound public policy" by subjecting both incumbents and new entrants to the "same regulatory terms and conditions."[6] As shown below, the Telecommunications Act does not support the Legislature's action, and FTIA's policy arguments are faulty.

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serves a public purpose, FTIA raises the specter of disruption of markets being served by "existing telephone companies, such as BellSouth and Cox Communications." *Id*. at 10. These statements and others like them suggested to FMEA that FTIA's brief was intended primarily to present the views of Florida's major incumbent telephone providers. Accordingly, most of the discussion in this brief will focus on the relationship between the incumbents and new municipal providers. Some of FMEA's points – e.g., that municipal providers are subject to numerous unique burdens as a result of their public status – do not just apply to the incumbents but also to all other private-sector telecommunications providers.

4 FTIA Brief at 8, 10.

5 *Acton v. Ft. Lauderdale Hospital*, 418 So. 2d 1099 (Fla. 1st DCA 1982); *Keating v. State*, 157 So. 2d 567 (Fla. 1st DCA 1963).

6 FTIA Brief at 8-9.

Robert Pepper, Chief of the Office of Planning and Policy of the Federal Communications Commission (FCC), has succinctly identified the fundamental flaw in the "level playing field" argument that FTIA espouses:

> [W]e hear all the time, the argument by incumbents, that ... "Well, we are regulated, but these new entrants, providing new services, are not regulated, and we need to have a level playing field. We need to make sure that everybody is treated the same." This is the argument about asymmetric regulation. There are two kinds of asymmetric regulation. One is where you have firms that are similarly situated and treated differently. That is a bad thing; it leads to all kinds of distortions. *Likewise, if you have two firms that are not similarly situated and are radically different in their circumstances, but you treat them the same, that also leads to all kinds of distortions.*[7]

In enacting the Telecommunications Act, Congress was well aware that incumbent telephone companies and new entrants were by no means "similarly situated." Indeed, the Supreme Court of the United States has expressly recognized that the Telecommunications Act "proceeds on the assumption that incumbent monopolists and contending competitors are unequal." *Verizon Communications, Inc. v. FCC*, 122 S. Ct. 1646, 1684 (2002). Recognizing that the incumbents had overwhelming advantages over new entrants, Congress armed the new entrants, the FCC and state regulators with "powerful tools to dismantle the legal, operational and economic barriers" posed by the incumbents' market power.[8]

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[7] R. Pepper, *Policy Changes Necessary to Meet Internet Development*, 2001 L. Rev. M.S.U.-D.C.L. 255, 257 (2001).

[8] *Public Utility Commission of Texas*, 1997 WL 603179, ¶ 2 (October 1, 1997) ("*Texas Order*").

Indeed, as the Supreme Court observed in *AT&T Corp. v. Iowa Utilities Board*, 525 U.S. 366, 378 (1999), "The 1996 Act can be read to grant (borrowing a phrase from incumbent GTE) "most promiscuous rights" … to competing carriers vis-à-vis the incumbents …."

At the same time, however, the Act was also generous to the incumbents. To offset the loss of their local monopolies, Congress granted the incumbents a host of important new rights, including the right to operate under substantially less regulation, the right to enter into vast new geographic and product markets – including long distance, equipment manufacturing and cable television – and the right to form strategic partnerships and other business relationships that had previously been foreclosed to them. By no means did Congress do what FTIA suggests – require or allow states to impose new burdens on potential entrants to protect *the incumbents* from "unfair" competition.

INTEREST OF *AMICUS CURIAE* FMEA

FMEA represents the interests of 32 public power communities across the state of Florida, including Alachua, Bartow, Blountstown, Bushnell, Chattahoochee, Clewiston, Fort Meade, Fort Pierce, Gainesville, Green Cove Springs, Havana, Homestead, Jacksonville, Jacksonville Beach, Key West, Kissimmee, Lakeland, Lake Worth, Leesburg, Moore Haven, Mount Dora, Newberry, New Smyrna Beach, Ocala, Orlando, Quincy, St. Cloud, Starke,

Tallahassee, Vero Beach, Wauchula and Williston. These communities own and operate municipal electric utilities that currently serve 25 percent of Florida's population - more than one million electric customer meters.

Municipal electric utilities are governed by elected city commissions or by appointed or elected utility boards. They are not-for-profit entities that raise capital through operating revenues or sale of tax-exempt bonds. After covering their costs, they support local government with transfer payments that help communities pay for fire and police protection and other important local services.

For more than a century, municipal electric utilities have provided their customers low-cost, reliable electric service and have furnished an industry-wide yardstick for efficient operation and superior quality of service. Now, they are well-situated to help their communities obtain meaningful competition in the telecommunications area as well as prompt and affordable access to advanced telecommunications services and capabilities.

In their core business of providing electric power, municipal electric utilities have huge demands for sophisticated communications infrastructure and facilities. These publicly-owned assets can readily support the provision of competitive voice, video and data services. Municipal electric utilities also have vast experience in providing high-technology services, billing customers of all kinds, furnishing technical support and addressing customer service needs. They also have access to poles, ducts, conduits and rights of way.

FMEA provides its members information and education to keep them abreast of significant developments in customer service, technology and law. FMEA also provides its members government relations assistance and litigation support in cases, such as this one, that may affect important interests of public power communities statewide.

The outcome of this case could have a significant bearing on whether, or to what extent, Florida's municipal electric utilities will step forward to provide their communities the advanced telecommunications services and capabilities that they need to achieve the full benefits of the Information Age. These benefits include the ability to attract new businesses and help existing ones to grow and thrive, the ability to provide residents progressive educational and employment opportunities, the ability to improve and reduce the costs of health care, and the ability to achieve a high quality of life. With interests of such magnitude at stake for its member communities, FMEA is filing this *amicus* brief to call the Court's attention to the flaws in the policy arguments that FTIA has presented in its *amicus* brief. FMEA submits that the discussion below will assist the Court in obtaining a fair and balanced understanding of the important policy issues that underlie this controversy.

STANDARD OF REVIEW

To the extent applicable, FMEA adopts the City of Gainesville's Statement of the Standard of Review.

STATEMENT OF THE CASE AND FACTS

To the extent applicable, FMEA adopts the City of Gainesville's Statement of the Case.

SUMMARY OF ARGUMENT

1. As Congress was well aware when it enacted the Telecommunications Act, the "playing field" in the telecommunications industry tips nearly vertically in favor of incumbent providers. To promote robust competition, Congress adopted numerous measures to offset these advantages and level the playing field *for the benefit of new competitors*. Among these measures was Section 253(a) of the Act, which prohibits states from erecting barriers to entry that "may prohibit, or have the effect of prohibiting the ability of any entity to provide any interstate or intrastate telecommunications service." While the FCC has questioned whether the term "any entity" in Section 253(a) applies to public entities as a matter of law, the FCC has repeatedly and consistently made clear that the pro-competitive *policies* underlying the Act apply to public entities. Thus, contrary to FTIA's suggestion, the Telecommunications Act furnishes no support for the *ad valorem* taxation at issue in this appeal.

2. Assuming (without conceding) that establishing a "level playing field" for public and private telecommunications providers is a legitimate state goal, subjecting entities that are not similarly-situated to the "same terms and conditions" undermines that goal. In imposing *ad valorem* taxation on municipal

telecommunications providers, the Florida legislature ignored the vast advantages that incumbents have over municipal providers. Furthermore, the legislature exacerbated the advantages that all private-sector providers have over municipal providers by revoking the traditional municipal immunity to *ad valorem* taxation while leaving intact the many regulatory and other burdens that apply only to municipalities. The Florida Legislature thus subjected municipalities to the "worst of both worlds" and tipped the playing field even further against them.

3. FTIA also makes a number of other claims for which it offers neither factual support nor rational argument. These include claims (1) that requiring municipalities to compete on an "equal footing" will result in "avoidance of monopoly pricing, more rapid technological advancements, and superior customer service and responsiveness;" (2) that if municipal property supporting competitive communications services is being used "for profit-making purposes," it is "only equitable that such property share in the same tax burden as other property that is being used for such purposes;" (3) that municipal "cherry picking" of the more lucrative customers will leave incumbent telephone companies at a severe disadvantage and ultimately result in higher consumer prices; (4) that the growth of municipal providers will cause private providers to lose market share and pay lower taxes to state and local governments; and (5) that municipalities will use their existing and publicly-supported infrastructure, without charge, to lay the groundwork for providing telecommunications services and "thus drastically

reduc[e] their start up and operational costs for providing telecommunications services."[9] As shown below, none of these claims has merit.

ARGUMENT

I. THE TELECOMMUNICATIONS ACT FURNISHES NO SUPPORT FOR THE IMPOSITION OF *AD VALOREM* TAXATION ON MUNICIPALITIES THAT BECOME PROVIDERS OF TELECOMMUNICATIONS SERVICES

A. The Telecommunications Act Reflects Congress's Intent to Counteract the Incumbents' Overwhelming Advantages Over New Entrants

On February 8, 1996, the President signed the Telecommunications Act of 1996 into law. Pub. L. No. 104-104, 110 Stat. 56, codified at 47 U.S.C. §§ 151 *et. seq*. As the Supreme Court has observed, this was "an unusually important legislative enactment." *Reno v. Amer. Civil Liberties Union*, 884 U.S. 844, 857 (1997). After decades of federal and state encouragement of monopolies in local telecommunications markets, "[t]he 1996 Act brought sweeping changes. It ended the monopolies that incumbent LECs [local exchange carriers] held over local telephone service by preempting state laws that had protected the LECs from competition." *GTE South, Inc. v. Morrison*, 199 F.3d 733, 737 (4th Cir. 1999). Through the Telecommunications Act, the federal Government "unquestionably" took "the regulation of local telecommunications competition away from the States." *Iowa Utilities Board*, 525 U.S. at 378 n.6.

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[9] FTIA Brief at 11.

The FCC has summarized the pro-competitive purposes of the Act as follows:

> [U]nder the 1996 Act, the opening of one of the last monopoly bottleneck strongholds in telecommunications -- the local exchange and exchange access markets -- to competition is intended to pave the way for enhanced competition in *all* telecommunications markets, *by allowing all providers to enter all markets.* The opening of *all telecommunications markets to all providers* will blur traditional industry distinctions and bring new packages of services, lower prices and increased innovation to American consumers. *The world envisioned by the 1996 Act is one in which all providers will have new competitive opportunities as well as new competitive challenges.*

In the Matter of Implementation of the Local Competition Provisions in the Telecommunications Act of 1996, 11 F.C.C.R. 15499, 1996 WL 452885, ¶ 4 (1996) ("*Local Competition Order*") (emphasis added).

In developing the Act, Congress recognized that incumbent telephone companies would have huge advantages over potential competitors, that the incumbents would have every incentive to thwart competition, and that strong measures were necessary to counteract these advantages.

> "[T]he removal of statutory and regulatory barriers to entry into the local exchange and exchange access markets, while a necessary precondition to competition, is not sufficient to ensure that competition will supplant monopolies. *An incumbent LEC's existing infrastructure enables it to serve new customers at a much lower incremental cost than a facilities-based entrant that must install its own switches, trunking and loops to serve its customers.* Furthermore, absent interconnection between the incumbent LEC and the entrant, the customer of the entrant would be unable to complete calls to subscribers served by the incumbent LEC's network. *Because an incumbent LEC currently serves virtually all subscribers in its local serving area, an incumbent LEC has little economic incentive to assist*

> *new entrants in their efforts to secure a greater share of that market. An incumbent LEC also has the ability to act on its incentive to discourage entry and robust competition* by not interconnecting its network with the new entrant's network or by insisting on supracompetitive prices or other unreasonable conditions for terminating calls from the entrant's customers to the incumbent LEC's subscribers.
>
> Congress addressed these problems in the 1996 Act by mandating that the most significant economic impediments to efficient entry into the monopolized local market must be removed. *The incumbent LECs have economies of density, connectivity, and scale; traditionally, these have been viewed as creating a natural monopoly.* As we pointed out in our [Notice of Proposed Rulemaking], the local competition provisions of the Act require that these economies be shared with entrants. We believe they should be shared in a way that permits the incumbent LECs to maintain operating efficiency to further fair competition, and to enable the entrants to share the economic benefits of that efficiency in the form of cost-based prices.

Local Competition Order ¶¶ 10-11 (emphasis added). Accordingly, to level the playing field *for the benefit of new competitors*, Congress "arm[ed] new entrants into previously closed telecommunications markets as well as [the FCC] and state regulators with powerful tools to dismantle the legal, operational and economic barriers that frustrated competitive entry in the past." *In the Matter of Public Utility Commission of Texas*, 13 F.C.C.R 3460, 1997 WL 603179 at ¶2 ("*Texas Order*").

Among the most important of these "powerful tools" was Section 253(a) of the Act. That provision reads, in its entirety, "No State or local statute or regulation, or other State or local legal requirement, may prohibit or have the effect of prohibiting the ability of any entity to provide any interstate or intrastate

telecommunications service." In the absence of such a provision, Congress believed, local telephone companies could counteract the pro-competitive purposes of the Act by promoting anticompetitive legislation at the state and local levels, where the incumbents had historically had enormous political influence:

> Historically, state legislatures and regulatory commissions exercised broad power to regulate telecommunications markets within their borders in ways that were designed to promote various social goals such as universal service or subsidized local telephone rates at the expense of competition. Indeed, until passage of the 1996 Act, states could and did award monopoly status to certain firms to provide service in prescribed areas within the state. Pursuant to section 253, such state actions are no longer permissible. *Through this provision, Congress sought to ensure that its national competition policy for the telecommunications industry would indeed be the law of the land and could not be frustrated by the isolated actions of individual municipal authorities or states, including, as in this case, the actions of state legislatures.*

Texas Order at ¶ 4.

Thus, far from seeking to establish a level playing field for the benefit of the incumbent telephone providers, as FTIA maintains, Congress attempted to do precisely the opposite in the Telecommunications Act.

B. Congress Intended that Municipal Electric Utilities Play a Major Role in Bringing Facilities-Based Competition to Their Communities, Particularly in Small Markets Such as Gainesville

As the legislative history of Section 253(a) makes clear, Congress intended that municipal electric utilities play a major role in providing meaningful facilities-based competition for their communities. This was particularly true for relatively

small markets, such as Gainesville, Florida, that might not otherwise be able to attract competitors from the private sector.

For example, at a Senate hearing that preceded the enactment of the Telecommunications Act, representatives of electric utilities of various kinds testified about the role that their utilities could play in assisting the Nation to meet its telecommunications goals. On behalf of the American Public Power Association (APPA), the trade association representing the interests of the Nation's 2,000 public power utilities, William J. Ray acquainted Congress with the remarkable accomplishments of the municipal electric utility of Glasgow, Kentucky, which had brought its small rural community into the Information Age, far exceeding the achievements of the private sector in many larger communities:

> In the 1980s, Glasgow, a community of 13,000 residents, was served -- but not very well -- by a single, for-profit cable company. The citizens were unhappy with the quality and the price of their cable TV service, so they turned to their municipally owned electric system for help. This plea from the public coincided with the city utility's recognition of the need for an effective demand-side management and load shedding system to avoid huge increases in power costs driven by surges in peak power demand. The Glasgow Electric Plant Board recognized that the same coaxial cable system used to deliver television programming could also be utilized by citizens to manage their power purchases. So our municipally owned electric utility built its coaxial distribution control system which also provides a competing, consumer-owned cable TV system. This new system not only allowed consumers to purchase electricity in real time and lower their peak electrical demand, thus saving money on their electric bills, it provided twice as many television channels as the competing, for-profit cable company at not-for-profit rates -- and delivered better service to boot. Big surprise -- the private company decided to drop its rates by roughly 50 percent and improve its service, too.

> But the Glasgow Electric Plant Board didn't stop there. We wired the public schools, providing a two-way, high-speed digital link to every classroom in the city. We are now offering high-speed network services for personal computers that give consumers access to the local schools' educational resources and the local libraries. Soon this service will allow banking and shopping from home, as well as access to all local government information and databases. We are now providing digital telephone service over our system. That's right -- in Glasgow, everyone can now choose to buy their dial tone from either GTE or the Glasgow Electric Plant Board.
>
> The people of Glasgow won't have to wait to be connected to the information superhighway. They're already enjoying the benefits of a two-way, digital, broadband communications system. And it was made possible by the municipally owned electric system.

Hearings on S.1822, The Communications Act of 1994, Before the Senate Committee on Commerce, Science and Transportation, 103d Cong, 2d Sess., A&P Hearings S.1822 (Westlaw) at 355-56 ("*Senate Hearings on S.1822*").[10]

Mr. Ray also testified that, with appropriate incentives, some public power utilities would follow in Glasgow's footsteps and provide competitive telecommunications services themselves, while other public power utilities would at least make their telecommunications infrastructure available to telecommunications providers:

> While all electric utilities have telecommunications needs, the manner in which these needs are met differs greatly among public

[10] Section 253(a) was derived *verbatim* from Section 230(a) of S.1822. Thus, in a brief in *City of Abilene, TX, v. FCC*, 164 F.3d 49 (D.C. Cir. 1999), the FCC acknowledged that the history of S.1822 is an integral part of the history of Section 253(a).

> power systems. Some public power systems satisfy their communications requirements primarily by leasing capacity from third parties. Other APPA members rely on communications systems built only to satisfy their own needs. Still others have built communications systems using some capacity on those systems for their own internal needs and leasing excess capacity to others (acting as the owner of a conduit rather than a telecommunications or information service provider). Finally, some public power communities have built communications systems to serve their own needs and to provide other telecommunications and information services to community residents and businesses.
>
> It is APPA's desire to ensure that whatever legislation is enacted, the diverse needs of the public power communities can be met. Specifically, this means that for those utilities who are likely to lease space over facilities owned by a third party, reasonable access terms, conditions and rates are required. For utilities that will develop and operate communications systems for their own use or to provide conduit but not content service to others, legislation should not saddle them with common carrier obligations. *Nor should legislation place obstacles in the path to public ownership of new telecommunications facilities or the public provision of telecommunications services. Indeed, the goals of universal service and vigorous competition can be enhanced if such public ownership and involvement is encouraged*.

Senate Hearings on S.1822 at *354-55 (emphasis added).

Shortly after Mr. Ray completed his testimony, Senator Trent Lott (R-MS), a Senate manager of the Telecommunications Act, observed "I think the rural electric associations, *the municipalities*, and the investor-owned utilities, are all positioned to make a real contribution in this telecommunications area, and I do think it is important that we make sure we have got the right language to accomplish what we wish accomplished here" (emphasis added). *Senate Hearings on S.1822* at *378-79.

Congress did indeed develop the "right language" – Section 253(a) of the Telecommunications Act. First, in summarizing the major features of the provision that became Section 253(a), a Senate report noted:

> 5. Entry by electric and other utilities into telecommunications
>
> S.1822 allows *all* electric, gas, water, [steam], and other utilities to provide telecommunications (section 302 of S.1822, new section 230(a)).

S. Rep. No. 103-367, 103d Cong., 2d Sess. 22 (1994), 1994 WL 509063 ("*Senate Report on S.1822*") (emphasis added). Section 302 contained various measures to promote competition and the "new Section 230(a)" contained the preemption language that the 104th Congress would later incorporate verbatim into Section 253(a). Thus, Congress clearly understood and intended that the preemption language that became Section 253(a) would allow "all" utilities to provide telecommunications services.

This conclusion is further strengthened by the history surrounding Congress's amendments to the Public Utility Holding Company Act of 1935 ("PUHCA"), which had prohibited certain investor-owned electric utilities from entering new lines of business, including telecommunications, that were outside their core electric business. To ensure that these electric utilities would be treated the same as municipal and cooperative electric utilities under the Telecommunications Act, Congress was willing to remove the relevant PUHCA restrictions. Thus, the *Senate Report on S.1822* explained:

First, electric utilities in general have extensive experience in telecommunications operations. Utilities operate one of the Nation's largest telecommunications systems-much of it using fiber optics. The existence of this system is an outgrowth of the need for real time control, operation and monitoring of electric generation, transmission and distribution facilities for reliability purposes. Within the utility world, registered holding companies are some of the more prominent owners and operators of telecommunications facilities. For example, one registered holding company, the Southern Co., has approximately 1,700 miles of fiber optics cables in use, with several hundred more miles planned.

Second, electric utilities are likely to provide economically significant, near-term applications such as automatic meter reading, remote turn on/turn off of lighting, improved power distribution control, and most importantly, conservation achieved through real-time pricing.

With real-time pricing, electric customers would be able to reprogram major electricity consuming appliances in their homes (such as refrigerators and dishwashers) to operate according to price signals sent by the local utility over fiber optic connections. Electricity costs the most during peak demand periods. Since consumers tend to avoid higher than normal prices, the result of real-time pricing would be significant "peak shaving"-reduction in peak needs for electric generation. Because electric generation is highly capital intensive, reductions in demand can become a driving force for basic infrastructure investment in local fiber optic connections. Registered holding companies are leaders in the development of real-time pricing technology.

Third, registered holding companies have sufficient size and capital to be effective competitors. Collectively, registered companies serve approximately 16 million customers-nearly one in five customers served by investor-owned utilities. Three registered companies who have been active in the telecommunications field, Central and South West, Entergy, and Southern Co., have contiguous service territories that stretch from west Texas to South Carolina.

Senate Report on S.1822 at 10-11 (emphasis added).

As Senator Lott subsequently confirmed during the floor debates on the Telecommunications Act, Congress was amending PUHCA "to allow registered electric utilities to join with *all other utilities* in providing telecommunications services, providing the consumer with smart homes, as well as smart highways." 141 Cong. Rec. S7906 (June 7, 1995) (emphasis added). Congress was thus very well aware of the contribution that municipal utilities could make to the fulfillment of the goals of the Telecommunications Act. Furthermore, Congress was also undoubtedly aware that public power utilities had the potential to make an even greater contribution than the registered holding companies, as public power utilities served approximately 35 million customers at the time, more than twice the number of customers served by the registered holding companies.

Following the enactment of the Telecommunications Act, a question arose about whether Congress had spoken with sufficient clarity in using the term "any entity" in Section 253(a) to require the FCC to preempt state laws prohibiting public entities, as well as private entities, from becoming providers of telecommunications services. The FCC answered this question negatively in the *Texas Order* and then again in *In re Missouri Municipal League*, 16 F.C.C.R. 1157, 2001 WL 28068 (January 12, 2001) ("*Missouri Order*"). The U.S. Court of Appeals for the D.C. Circuit upheld the *Texas Order* in *City of Abilene, Texas, v. FCC*, 164 F.3d 49 (D.C. Cir. 1999). More recently, however, the U.S. Court of Appeals for the Eighth Circuit rejected the D.C. Circuit's rationale in *Abilene* and

overturned the *Missouri Order*. *Missouri Municipal League v. FCC*, 299 F.2d 949 (8th Cir. 2002).[11]

While the FCC may believe that Congress did not speak clearly enough in Section 253(a) as a matter of law, the Commission has repeatedly held that the pro-competitive *policies* underlying the Telecommunications Act apply with full force to public entities:

> [M]unicipally-owned utilities and other utilities have the potential to become major competitors in the telecommunications industry. *In particular, we believe that the entry of municipally-owned utilities can further the goal of the 1996 Act to bring the benefits of competition to all Americans, particularly those who live in small or rural communities.* We emphasized this fact in our August 2000 report on the deployment of advanced services. In that report, we presented a case study detailing advanced services deployment in Muscatine, Iowa where the municipal utility competes with other carriers to provide advanced services to residential customers....Our case study is consistent with APPA's statements in the record here that municipally-owned utilities are well positioned to compete in rural areas, particularly for advanced telecommunications services, because they have facilities in place now that can support the provision of voice, video, and data services either by the utilities, themselves, or by other providers that can lease the facilities.

Missouri Order ¶ 10; *see also Texas Order* ¶ 179.

The statement quoted above expressed the unanimous view of all five of the FCC's commissioners. Three commissioners filed separate statements, to underscore the FCC's strong support for municipal entry into telecommunications,

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[11] A federal district court has also struck down Virginia's barrier to entry as contrary to Section 253 of the Telecommunications Act. *City of Bristol, VA v. Earley*, 145 F. Supp. 2d 741 (W.D.Va. 2001) (vacated as moot following enactment of corrective state legislation).

and to ensure that no one would interpret the FCC's failure to preempt the Texas and Missouri laws as support for what the legislatures of those states had done.

Chairman William Kennard and Commissioner Gloria Tristani emphasized that the FCC's decision to uphold the Missouri statute, "while legally required, is not the right result for consumers in Missouri." *Missouri Order*, Joint Separate Statement of Commissioners Kennard and Tristani. "Unfortunately," Chairman Kennard and Commissioner Tristani continued, "the Commission is constrained in its authority to preempt HB 620 by the D.C. Circuit's *City of Abilene* decision and the U.S. Supreme Court's decision in *Gregory v. Ashcroft*."[12] *Id*.

Commissioner Susan Ness elaborated in her own separate statement:

> I write separately to underscore that today's decision not to preempt a Missouri statute does not indicate support for a policy that eliminates competitors from the marketplace. In passing the Telecommunications Act of 1996, Congress sought to promote competition for the benefit of American consumers.
>
> In the Telecommunications Act, Congress recognized the competitive potential of utilities and, in section 253, sought to prevent complete prohibitions on utility entry into telecommunications. The courts have concluded, however, that section 253 is not sufficiently clear to permit interference with the relationship between a state and its political subdivisions. [Citing *City of Abilene*].
>
> Nevertheless, municipal utilities can serve as key players in the effort to bring competition to communities across the country, especially those in rural areas. In our recent report on the deployment of advanced telecommunications services, we examined Muscatine, Iowa, a town in which the municipal utility was the first to deploy broadband facilities to residential consumers. The telephone and

[12] *Gregory v. Ashcroft*, 501 U.S. 452 (1991).

> cable companies in Muscatine responded to this competition by deploying their own high-speed services, thereby offering consumers a choice of three broadband providers. It is unfortunate that consumers in Missouri will not benefit from the additional competition that their neighbors to the north enjoy.

Missouri Order, Separate Statement of Commissioner Ness.

Congress's intent that municipal utilities play a significant role in bringing competition to telecommunications markets takes on particular force in view of Congress's long experience with, and profound understanding of, the electric power industry. For more than a century, Congress has repeatedly heard – and rejected – complaints from private-sector utilities about the supposed unfair advantages that municipal utilities enjoy.[13] Not surprisingly, there was not a word in the language or lengthy legislative history of the Telecommunications Act that hinted of any congressional intent to change the balance of advantages and disadvantages affecting public and private providers of telecommunications services.

In summary, the language and the legislative history of the Telecommunications Act, as well as the FCC's many interpretations of it, all refute FTIA's claim that Congress intended to protect incumbent telephone companies from competition by subjecting incumbents and new entrants alike to the same

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[13] *See, e.g.*, R. Rudolph and S. Ridley, *Power Struggle: The Hundred Year War Over Electricity*, at 48-49 (1986); C. Beard, *American City Government* at 218-24 (1912); J. Fairlie, *Essays in Municipal Administration*, at 262-270 (1908); Moody's Magazine, Vol. II, No.5, *Symposium – Municipal Ownership and Operation*, at 500-544 (October 1906).

requirements, burdens and obligations. To the contrary, these authorities make clear that Congress had exactly the opposite intent.

II. THE *AD VALOREM* TAXATION AT ISSUE WAS INTENDED TO THWART ENTRY BY MUNICIPAL UTILITIES AND DOES NOT CREATE A "LEVEL PLAYING FIELD"

A. The Measure at Issue Here Was One of a Wave of State Barriers to Entry That Incumbents Promoted Following the Enactment of the Telecommunications Act to Thwart Municipal Entry

To appreciate the anti-competitive purposes of the *ad valorem* taxation that is at issue here, it is useful to put that measure into its historical context.

The Telecommunications Act passed with vast majorities in both the House of Representatives (414-16) and the Senate (91-5), in large part because the major incumbent local telephone companies agreed to a landmark compromise. The incumbents agreed to relinquish their entrenched monopolies in local markets, but in return, they received many significant concessions. These included the right to operate under substantially less regulation, the right to enter into vast new geographic and product markets -- including long distance, equipment manufacturing and cable television -- and the right to form strategic partnerships and other business relationships that had previously been foreclosed to them.

Soon after the Telecommunications Act became law, however, the incumbents reneged on their promises to open their local markets to competition.[14]

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[14] H. Frisby, Jr., and J. Windhausen, Jr., *Bell Companies Thwart Competition*, Charleston Gazette (September. 25, 2002), http://www.wvgazette.com/

To thwart potential competition from municipal electric utilities, the incumbents promptly introduced measures in several states that took different routes to the same end – to completely stop or significantly delay municipal entry.

Southwestern Bell and Verizon focused on obtaining outright prohibitions on municipal entry. Through massive lobbying efforts, they succeeded in persuading the legislatures of Texas,[15] Arkansas,[16] Missouri[17] and Virginia[18] to enact such explicit bans. BellSouth preferred a more subtle strategy – it pursued

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display_story.php3?sid=200209246&format=prn; J. Glassman, *For Whom the Bells Still Toll*, Washington Times (April 25, 2001), http://www.aei.org/ra/raglas010425.htm; AT&T News Release, *AT&T Files Petition For Structural Separation of BellSouth*, (March 21, 2001), http://www.att.com/news/item/0,1847,3720,00.html.

[15] Texas Utilities Code, § 54.201 *et seq*. barred municipalities and municipal electric utilities from providing telecommunications services either directly or indirectly through a private provider.

[16] Ark. Code § 23-17-409 prohibited municipalities from providing local exchange service.

[17] Revised Statutes of Missouri § 392.410(7) barred municipalities and municipal electric utilities from selling or leasing telecommunications services or telecommunications facilities, except services for internal uses; services for educational, emergency and health care uses; and "Internet-type" services.

[18] Virginia Code § 15.2-1500 barred municipalities (except all localities located adjacent to exit 17 on Interstate 81 (the home of a prominent member of Congress) from providing telecommunications services or facilities to the public.

what Hazlett and Ford have called "a faux symmetry in regulation [to] divert policymaker and administrative processes from promoting competitive entry."[19]

Specifically, BellSouth's approach was to ignore its vast advantages of incumbency and pretend that it was at a severe *disadvantage* because of the supposed tax and other regulatory advantages that municipal utilities enjoy. In Florida, BellSouth maintained that removing the traditional municipal immunity to *ad valorem* taxation was necessary to create a "level playing field."

As the Florida legislature was deliberating the measure at issue in this litigation, the *Wall Street Journal* ran a lengthy article that exposed the true purposes of the legislation that BellSouth and its allies were promoting -- "The companies figure that, stripped of their financial perks, cities would be less likely to enter the telecommunications market." J. Ball, *Georgia Cities Face Battle to Enter Telecom Area*, Online Wall Street Journal (March 26, 1997). Steven Langford, a Georgia state senator who was sponsoring a similar BellSouth-promoted bill in Georgia at the time, acknowledged that the bill was intended to stop municipal entry in its tracks: "We will see that [cities] can't compete if they don't have these unfair advantages." *Id*.

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[19] T. W. Hazlett and G.S. Ford, *The Fallacy of Regulatory Symmetry: An Economic Analysis of 'the Level Playing Field' in Cable TV Franchising Statutes*, 3 Business and Politics 21, 43 (2001), http://www.manhattan-institute.org/hazlett/the_fallacy_of_regulatory_symm.pdf.

Subjecting entities that are not similarly situated to the same regulatory requirements does not achieve a "level playing field." To the contrary, doing so works decisively in the incumbents' favor and destroys or significantly impairs any real prospect of competition. In fact, as indicated above, the Supreme Court has expressly recognized that the Telecommunications Act "proceeds on the assumption that incumbent monopolists and contending competitors are unequal." *Verizon*, 122 S.Ct. at 1684. Thus, the Act not only gives new entrants, the FCC, and state regulators "powerful tools" to pry open local telecommunications markets, but it also uses the same approach to assist *incumbents* in becoming more effective competitors in markets from which they were previously excluded – long distance, equipment manufacturing, etc.

The courts, too, have accepted the principle that treating dissimilarly situated entities the same results in discrimination against new entrants. For example, in determining whether local franchising authorities have granted franchises to new entrants with more favorable terms than those in the incumbent's franchise, the courts have consistently held that franchising authorities can take into account the significant advantages of incumbency. *See, e.g.*, *Comcast Cablevision of New Haven, Inc. v. Connecticut DPUC*, 1996 WL 6611805 at *4 (Conn. Super. Ct. 1996) ("Plaintiff's argument that the advantage of incumbency is not supported ignores undisputed evidence in the record."); *New England Cable Television Ass'n, Inc. v. Department of Public Utility Control*, 27 Conn. 95, 717 A.2d 1276, 1292

n.27 (1998) ("there are certain benefits that inherently inure to the plaintiffs' status as incumbents"); *Insight Communications, L.P. v. City of Louisville, KY*, No. 00-CI-007100 (Jefferson Cir. Ct. March 21, 2001) ("There will never be an apple-to-apple comparison for Insight and another franchisee simply because Insight is the incumbent which in its own right and through its predecessors has been the exclusive provider of cable television services in the City of Louisville for almost thirty years. No new cable television franchises can ever be in the same position as a thirty-year veteran.") (Attachment A)[20]

In summary, there is no support in the Telecommunications Act, the FCC's interpretations or case law for FTIA's policy arguments. FMEA urges the Court not be misled by FTIA's "fallacy of symmetry."

B. Subjecting Municipal Providers of Telecommunications Services to *Ad Valorem* Taxation Does Not Create a "Level Playing Field" But Exacerbates the Advantages of Private Sector Providers

Assuming (without conceding) that establishing a "level playing field" for public and private telecommunications providers is a legitimate state goal, the Florida Legislature did not advance that goal by imposing *ad valorem* taxation on municipal telecommunications providers. Not only did the Legislature widen the gap between the incumbents and municipal providers, but by removing the traditional municipal immunity to *ad valorem* taxation while leaving intact the

[20] A copy of the opinion is available online at http://www.baller.com/pdfs/loukydecision.PDF.

many regulatory and other burdens that apply only to municipalities, the Legislature also put municipalities at a greater disadvantage vis-à-vis *all* private-sector providers.

As the FCC recognized in its *Local Competition Order*, incumbent telephone companies have at least the following advantages over new entrants:

> "An incumbent LEC's existing infrastructure enables it to serve new customers at a much lower incremental cost than a facilities-based entrant that must install its own switches, trunking and loops to serve its customers." -- This infrastructure, moreover, was paid for with monopoly rents obtained without risk during decades when incumbents were guaranteed profits and faced no competition.
>
> "[A]n incumbent LEC currently serves virtually all subscribers in its local serving area."
>
> "An incumbent LEC also has the ability to act on its incentive to discourage entry and robust competition by not interconnecting its network with the new entrant's network or by insisting on supracompetitive prices or other unreasonable conditions for terminating calls from the entrant's customers to the incumbent LEC's subscribers."
>
> "The incumbent LECs have economies of density, connectivity, and scale."

Local Competition Order, ¶ ¶ 10-11.

Similarly, the Florida Public Service Commission sets forth on its website the following "non-inclusive list" of barriers that new entrants face vis-à-vis incumbents:

> Name recognition of incumbent local exchange companies
>
> Building awareness of entrants and their services

Lack of a network infrastructure for facilities-based providers

Development of resale and operational arrangements

Start-up costs

Interconnection arrangements

Unbundling

Number Portability

Operations and maintenance

Customers service (including billing systems)

Florida Public Service Commission, *Local Competition* (November 4, 2002), http://www.psc.state.fl.us/local-compet/local-compet.cfm.

Furthermore, major incumbent telephone companies also have all of following advantages, and private-sector providers of all kinds benefit from many of them:

> **Economies of Scale** – Incumbents and other major communications companies, such as AT&T Comcast and Cox, operate in large multi-state markets. This allows them to achieve economies of scale in finance, management, workforce, R&D, administration, etc. They can purchase plant, equipment and supplies, advertising and other requirements in sufficient amounts to support regional or national operations and at substantial quantity discounts. In the absence of effective competition, they can also control the price, quality and content of the services they provide.
>
> By contrast, municipal providers are usually limited to operating wholly or primarily in their own local communities. They must live with the constraints posed by their relatively small size and can succeed only if they can offer advantages in price and quality of service.

Confidential Operations – All private-sector providers are largely free to operate behind closed doors, subject only to general corporate record-keeping and reporting requirements. They need not disclose their marketing strategies, prospective partners or customers or even the details of their ongoing business arrangements. Their leaders are appointed rather than elected and therefore are not subject to constant public scrutiny and criticism.

Municipal providers, as custodians of the public interest, must comply with all relevant Sunshine and Open Records requirements, and they must inform the public fully about all major decision and win approval before proceeding.

Flexibility in Employment -- Subject only to routine labor laws, private-sector providers are free to hire and promote whomever they wish, to offer competitive salaries and benefits, and, with relative ease, to remove persons who are not performing up to expectations.

Municipal providers are typically constrained by civil service requirements, relatively inflexible compensation programs and budgetary limitations.

Advantages in Obtaining Financing – Incumbents and other large communications companies can usually arrange for financing more quickly and privately, and, because of their size and market power, can often secure preferred rates and flexible terms.

While opponents of municipal involvement in telecommunications often complain that municipalities a substantial advantage because they have access to tax-exempt financing, obtaining such financing is a complex, time-consuming and burdensome process requiring public disclosure, extensive debate and prior public approval. Such financing also typically is accomplished through bond agreements that impose substantial limitations on the uses of the funds in question.

Flexibility in Contracting – Private-sector providers are free to enter into any lawful contracts that they believe to be in their best interests.

> Municipal providers are typically subject to cumbersome competitive bidding requirements; restrictions in bond agreements; conditions on wages imposed by the requirements such as the Davis-Bacon Act; obligations under "Buy American," minority set-aside and similar programs; and restrictions on the kinds of relationships that publicly-owned utilities can enter with private entities.
>
> **Tax Advantages** – Incumbents and other major communications companies have access to billions of dollars of tax credits, deductions and other incentives, and these benefits will increase even more with the enactment of the Economic Security and Recovery Act of 2001.[21]
>
> Claims that municipal providers have a significant competitive advantage because they are not subject to federal, state and local taxation do not account for the transfers to the general fund in lieu of taxes that municipal utilities typically pay. Municipal providers do not pay income taxes because they do not earn profits.

The Florida legislature ignored these disadvantages of municipal providers and added to their burdens by subjecting them to *ad valorem* taxation as well. By no means can this action be justified as a means of ensuring "fair and equitable entry of municipal competitors," as FTIA suggests.[22]

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[21] A report by MSB Energy Associates, *Major Federal Tax Breaks that Lower Investor-Owned Utility Costs and U.S. Treasury Revenues* (2001) http://www.appanet.org/pdfreq.cfm?PATH_INFO=/Newsroom/releases/MSBreport.pdf&VARACTION=GO, finds that investor-owned electric utility costs and revenue requirements would have been $7.5 billion higher in 1998 had it not been for the benefits that these utilities received from the three major tax incentives analyzed and that the cumulative loss to the U.S. Treasury from 1954-1996 was more than $300 billion.

[22] FTIA Brief at 8.

III. NONE OF FTIA'S OTHER POLICY ARGUMENTS HAS MERIT

FTIA makes a number of other policy statements in support of the *ad valorem* taxes at issue, but it has offered neither factual evidence nor reasoned argument to sustain these contentions.

First, FTIA claims that requiring municipal providers to compete on an "equal footing" will result in avoidance of monopoly pricing, more rapid technological advancements, and superior customer service and responsiveness.[23] More than six years after the enactment of the Telecommunications Act, and five years after the enactment of the *ad valorem* taxation at issue, incumbents still control 95.6 percent of Florida's residential market and 92 percent of the total Florida market, and most of the competition is resold incumbent service. Florida Public Service Commission, *Competition in Telecommunications Markets in Florida* (December 2001). Monopoly pricing *by the incumbents* continues, and residents of Florida have achieved none of the other benefits that FTIA mentions.[24]

Second, FTIA asserts that if municipal property supporting competitive communications services is being used "for profit-making purposes," it is "only equitable that such property share in the same tax burden as other property that is

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[23] FTIA Brief at 10.

[24] Consumer Federation of America, *Florida Consumers Losing Out Over Failure of Local Phone Competition* (January 23, 2001), http://www.consumerfed.org/fl.telecom.0101.pdf.

being used for such purposes."[25] The short answer is that municipal providers do not make profits; they cover their costs and then make sizable payments to their local governments to support other essential municipal functions. Furthermore, both large and small private-sector communications providers have access to significant tax credits, tax deductions and other tax benefits that are not available to municipal providers.[26]

Third, FTIA maintains that, as municipal providers grow, private providers will lose market share and pay lower taxes to state and local governments.[27] For one thing, FTIA's contention ignores the fact that, as municipal providers grow, so will the payments they make to local governments. In the electric power area, nationwide data indicate that the median contribution by publicly owned electric utilities make is 14 percent higher than investor-owned utilities'. APPA, *Straight Answers to False Charges About Public Power* at 31 (2002), http://www.appanet.org/pdfreq.cfm?PATH_INFO=/about/why/answers/straightanswers.pdf&VARACTION=GO.

Fourth, FTIA claims that incumbents have universal service obligations and must use profits from their most lucrative customers to subsidize service to less-profitable or unprofitable customers. If municipalities are allowed to use their tax

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25 FTIA Brief at 10-11.

26 *See* MSB Energy Associates Report cited in footnote 28, *supra*.

27 FTIA Brief at 11.

advantaged status to gain a cost advantage that, in turn, enables them to "cherry pick" the incumbents' more lucrative customers, and the incumbents will have no choice but to raise prices to the majority of citizens.[28] FTIA fails to note that Section 254 of the Telecommunications Act, 47 U.S.C. § 254, established a massive, multi-billion dollar universal service program that, among other things, subsidizes entities that provide universal service. Indeed, some of these subsidies are available only to incumbents that offer service throughout their marketing territories. Thus, even if incumbents lost some of their most lucrative customers to municipalities – or, for that matter, to other competitors – the majority of the incumbents' customers would not suffer.

Fifth, FTIA claims that many municipalities seeking to provide telecommunications services could use their existing and publicly-supported infrastructure and facilities to lay the groundwork for providing telecommunications services and thus drastically reduce startup and operational costs of providing telecommunications services.[29] To be sure, municipalities have infrastructure, facilities and other publicly-supported utility assets that they could use to become major competitors in the telecommunications area. That is exactly why Congress was so eager to have them step forward quickly to compete with the incumbents. There is nothing untoward about this, particularly since municipal

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[28] FTIA Brief at 11.

[29] FTIA Brief at 12 n.4.

providers typically take pains in allocating costs to avoid cross-subsidization. Moreover, the incumbents themselves have infrastructure, facilities and other assets that the public bought over the decades through the monopoly rents that they paid to the incumbents.

In summary, none of FTIA's claims withstands analysis.

CONCLUSION

For the reasons set forth above, FMEA submits that the Court should not consider FTIA's policy arguments at all or should find that they are without merit.

Respectfully submitted,

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November 4, 2002

CERTIFICATE OF SERVICE

I certify that a copy of the foregoing has been furnished by United States Mail this 4th day of November, 2002, to Nicholas Bykowsky, Esquire, Office of the Attorney General, Tax Section, the Capitol, Tallahassee, Florida 32399-1050; and by United States Mail to Michele Santi and John C. Dent, Jr., Dent & Cook, 330 S. Orange Avenue, Sarasota, Florida 34236; Kenneth R. Hart and Sean E. Fennelly, Ausley & McMullen, Post Office Box 391, Tallahassee, Florida 32302, and Robert Pass and E. Kelly Bittick, Jr., Carlton Fields, P.A., 215 S. Monroe Street, Suite 500, Tallahassee, Florida 32301-1866.

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