Conversations With...

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Federal Preemption vs. State Authority over Municipal Broadband

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In this edition of Washington Legal Foundation's CONVERSATIONS WITH, the Chairman of WLF's Legal Policy Advisory Board, **Jay B. Stephens**, directs a discussion with Federal Communications Commission (FCC) Commissioner **Ajit Pai** and General Counsel of the National Governors Association **David Parkhurst**, on an FCC order issued earlier this year that prohibits state governments from limiting municipalities' broadband services. The Order, as the participants discuss, has serious implications for the constitutional concept of dual sovereignty and the federal government's authority to regulate Internet services.

Jay Stephens: A February 26, 2015 FCC Order informed Tennessee and North Carolina that the federal Telecommunications Act preempts state laws that limit local government-owned broadband networks to operating within their municipal geographic boundaries. The Commission was responding to petitions by cities within those states that wished to expand their broadband networks to adjacent areas. The Order concluded that the state laws are at odds with § 706 of the Act, which empowers the FCC to "encourage the deployment" of advanced communications services through "measures that promote competition in the local telecommunications market, or other regulating methods that remove barriers to infrastructure investment." Commissioners Pai and Michael O'Rielly dissented from the Order. Tennessee and North Carolina filed administrative challenges to the FCC's Order that have been consolidated in the U.S. Court of Appeals for the Sixth Circuit.

Mr. Stephens: David, what role have state legislatures and regulatory agencies played in municipal broadband?

Mr. Parkhurst: States, as sovereigns, enact laws and regulations on a myriad of policy issues including broadband communications. This authority is fundamental to setting statewide priorities, protecting citizens, and providing a macro perspective that shapes core economic, social, and budgetary directions in each state.

What is ironic in the case of municipal broadband is that the states are not faulted for prohibiting their municipalities from owning broadband networks. Both Tennessee and North Carolina permit municipal broadband deployment. They're facing preemption for apparently not providing the scope of unfettered authority that unelected federal regulators believe they should.

This is a big reason why the National Governors Association, the National Conference of State Legislatures (NCSL), and the Council of State Governments (CSG) filed a joint *amici*

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curiae brief with the Sixth Circuit in this matter.

Mr. Stephens: What is the rationale behind internal state geographical limits on municipal-broadband entities offering their services?

Mr. Parkhurst: States have a strong interest in overseeing the process by which municipal-broadband networks are designed and approved because states maintain ultimate responsibility for the well-being of the cities and towns within their borders.

Building and maintaining municipal-broadband networks costs money and time. Once a broadband network is up and running, its costs do not end at start-up because the investment is a long-term commitment.

Municipalities that construct broadband networks must constantly manage, maintain, and upgrade their networks to stay competitive with private providers. If a municipal-broadband network expands too quickly, loses customers, experiences service interruptions, misses revenue projections, or encounters some other difficulty, those costs raise the risk of financial default by local government, the diversion of resources from other priorities, or other negative outcomes such as credit downgrades.

Mr. Stephens: Commissioner Pai, can you provide some legal background on the FCC's authority in this area?

Commissioner Pai: Sure. Section 706(a) provides that the FCC and state utility commissions "shall encourage the deployment on a reasonable and timely basis of advanced telecommunications capability to all Americans" by adopting "price cap regulation, regulatory forbearance, measures that promote competition in the local telecommunications market, or other regulating methods that remove barriers to infrastructure investment." [§ 706(a) of the Telecommunications Act of 1996, codified at 47 U.S.C. § 1302(a)] Section 706(b), in turn, provides that if the FCC determines that advanced telecommunications capability is not being deployed "in a reasonable and timely fashion," the Commission "shall take immediate action to accelerate deployment of such capability by removing barriers to infrastructure investment and by promoting competition in the telecommunications market." [47 U.S.C. § 1302(b)]

Mr. Stephens: In the February Order, three Commissioners decided that § 706 of the Telecommunications Act granted FCC the authority to preempt the laws of Tennessee, North Carolina, and presumably other states. What legal rationale supported that conclusion?

Commissioner Pai: The FCC's majority argued that because it believed that broadband had not been deployed "in a reasonable and timely fashion," § 706 authorized the FCC to preempt state restrictions on municipal broadband—laws that, it suggested, "stand as a barrier to infrastructure investment and broadband deployment, or that inhibit competition in the telecommunications market." Although § 706 does not specifically mention preemption, the majority asserted that preemption nonetheless "falls within the 'measures to promote competition in the local telecommunications market' and 'other regulating methods' of § 706(a) that Congress directed the Commission to use."

Notably, the majority did *not* purport to preempt state laws prohibiting municipal broadband projects altogether. This would be "a different question," the Order stated—implicitly conceding that a state retained plenary power to bar such projects. But where a state authorizes municipalities to

operate a broadband network, and then imposes conditions on that authorization, the majority claimed the FCC had the power to preempt.

Mr. Stephens: Commissioner Pai notes that the Order did not touch upon states' authority to prohibit municipal broadband outright. David, could the FCC do that?

Mr. Parkhurst: Great question. The short answer is that Congress did not give the FCC the authority under the federal Telecommunications Act to preempt state authority to govern their instrumentalities. The FCC, however, justifies its audacious preemption order by distinguishing between "core state control of political subdivisions," which the FCC correctly admits it cannot stop absent clear authority from Congress, and state laws governing the provision of broadband by a political subdivision. Here, the foundational decision by a state to grant its authority to establish municipal broadband represents an issue of core control by a sovereign over its political subdivisions.

However, the FCC's reasoning is that once a state exercises its authority and permits political subdivisions to establish broadband networks, then subsequent state laws regarding those networks are fair game for FCC preemption because core state authority is untouched. Rather, the FCC is preempting only those state laws that, in its view, allegedly block municipalities from exercising their state-granted authority fully and that—more to the point—conflict with federal policy that supports broadband deployment.

The FCC's distinction touches upon the doctrine of dual sovereignty. This doctrine developed by our Founders holds that both the federal and state governments are co-equal sovereigns. The Constitution balances broad and reserved powers to the states against express and limited powers to the federal government, provided if there is a conflict the latter is generally supreme over the former. In Federalist No. 45, Madison declared that "[t]he powers delegated by the proposed Constitution to the federal government are few and defined. Those which are to remain in the State governments are numerous and indefinite." His assertion that "ambitious encroachments of the federal government … would be signals of general alarm (for the states)" assumed that the states would rally around to resist federal usurpation of state authority just as the people did against the British. [Federalist No. 46]

Madison explained that if the federal government were to overreach, the powers of states to oppose it are substantial including "disquietude of the people … refusal to cooperate with the officers of the Union … and frowns of the executive magistracy of the State." The NGA-NCSL-CSG brief affirms that, more than 200 years later, Madison was onto something.

Mr. Stephens: Why is states' sovereign authority over municipalities so critical?

Mr. Parkhurst: Sovereign states create political subdivisions. The United States Supreme Court has said that, "the city is a political subdivision of the state, created as a convenient agency for the exercise of such of the governmental powers of the state as may be intrusted [*sic*] to it." [*Town of Mt. Pleasant v. Beckwith*, 100 U.S. 514, 520 (1879)] Their relationship to the states is vastly different from the federal-state "dual sovereign" relationship. [*City of Trenton v. State of New Jersey*, 262 U.S. 182, 185 (1923)]

Removing states from the decision-making process over municipal-broadband

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networks is negligent because the potential fiscal failure of not just a startup broadband business, but also an entire local government that provides an array of critical public services is at stake.

Municipalities are created and bound by state law. Their actions are subject to judicial review in state courts. They are fiscally tied to the state, and they are ultimately responsible to the states. States create political instrumentalities such as municipal corporations and "the number, nature, and duration of the powers conferred upon these corporations and the territory over which they shall be exercised rests in the absolute discretion of the State." [*Hunter v. Pittsburgh,* 207 U.S.161, 178 (1907)]

Mr. Stephens: Commissioner Pai, can you elaborate on the FCC's legal rationale that it could not prevent states from prohibiting municipal broadband, but that federal law preempts limits on such services once the state allows them?

Commissioner Pai: The Order suggested that § 706 empowers the FCC to displace state laws that "effectuate choices about the substance of communications policy that conflict with federal communications policy designed to ensure 'reasonable and timely' deployment of broadband." Thus, to the extent that a state opened the door to municipal broadband but then attached conditions that conflicted with FCC broadband deployment policies, federal preemption came into play. The Order offered the following analysis of why this was so:

> To take an example, where a state allows political subdivisions to provide broadband, but then imposes regulations to 'level the playing field' by creating obligations apparently intended to mirror those borne by private providers, it does so in order to further its own policy goals about optimal competitive and investment conditions in the broadband marketplace. The states here are deciding that incumbent broadband providers require protection from what they regard as unfair competition and [are] regulating to restrict that competition. This steps into the federal role in regulating interstate communications.

Conversely, if a state barred municipal broadband altogether, the Order implied that no conflict with federal policies would arise, and preemption would not be possible.

Mr. Stephens: Why is that rationale flawed?

Commissioner Pai: As I explained in my dissent from the Order, the FCC's position yielded an exceptionally strange result. While a state would be free to ban municipal-broadband projects outright, it would be forbidden from imposing more modest restrictions on such projects. In other words, the most severe state law restrictions on municipal-broadband projects (prohibitions) *could not* be preempted, whereas less stringent restrictions (those that purportedly do not amount to prohibitions) *could* be preempted.

A simple example illustrates the oddity here. Suppose that the federal government attempted to tell the State of Tennessee that it could not limit the City of Chattanooga's Police Department to enforcing the law in Chattanooga. Instead, once the state authorized the city to have a police department, it was required to let Chattanooga's police officers have free rein to patrol from Memphis to Knoxville. Would anyone seriously contend that such an edict from the federal government wouldn't interfere with Tennessee's ability to order

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its political subdivisions? Of course not. As David said, Congress did not adopt, much less intend, such a convoluted framework when it enacted the Telecommunications Act of 1996. For example, if a state is denied the power to authorize municipalities to offer broadband service with conditions, it will be less likely to authorize them to do so at all. And if, as the Commission suggested, municipal-broadband projects truly advance § 706's aim of enhancing broadband deployment and competition, it would seem odd to interpret the statute in a manner that would push states toward prohibiting municipal-broadband projects altogether.

Interestingly, the majority's view also contradicts longstanding Commission policy. For instance, in 1997, the Clinton-era FCC explicitly encouraged states to impose restrictions on municipal entry into the telecommunications market that would fall short of a total prohibition. Noting the tension between the possible benefits of greater competition through municipal entry and the risks of taxpayer liability and regulatory bias in favor of public providers, the agency opined that a balance could be struck "successfully through measures that are much less restrictive than an outright ban on entry, permitting consumers to reap the benefits of increased competition."

Mr. Stephens: Is the Commission's line between state prohibition and state regulation a tenable one?

Commissioner Pai: No, it's an artificial, untenable line. This is because all conditions on the provision of services are effectively prohibitions when those specified conditions are not satisfied.

For example, take a state law dictating that a municipality may not offer broadband service so long as at least one private broadband provider is offering service to all residents of that municipality. The Commission probably would claim that such a law would be a restriction on municipal-broadband projects subject to preemption under § 706 because it does not forbid a municipality from providing broadband service in all circumstances. But in reality, that law would function as a prohibition as applied to any municipality where all residents are being offered broadband service by a private provider.

Or consider a state law providing that municipalities are authorized to operate municipal-broadband projects beginning January 1, 2020. Would that condition as to timing be a restriction that could be preempted using § 706? Or would it be a prohibition on municipal broadband projects through the end of 2019 that could not be preempted?

In short, as I see it, the heart of the Commission's analysis rested not on a principled distinction but semantics. And the basic fact remains: Through preemption, the Commission attempted to give municipalities in Tennessee and North Carolina authority that their state governments had not given them.

This approach interferes with "States' arrangements for conducting their own governments," as the Supreme Court put it in *Nixon v. Missouri Municipal League* [541 U.S. 125, 140 (2004)] because it was inconsistent with the fundamental principle that a state has "absolute discretion" to determine the "number, nature, and duration" of the powers it wishes to entrust to its municipalities. [*Wisconsin Pub. Intervenor*, 501 U.S. at 607–08 (citations omitted); *Holt Civic Club*, 439 U.S. at 71 (quoting *Hunter v. Pittsburgh*, 207 U.S. 161, 178 (1907))] As a result, there had to be a clear statement that Congress intended to give the Commission the authority to

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infringe upon state sovereignty—a clear statement found nowhere in § 706.

Mr. Stephens: Prior to this order, had the FCC specifically encouraged or discouraged municipal broadband and states' regulation of that activity?

Commissioner Pai: The FCC itself hadn't sauntered down this path before with respect to broadband. But over a decade ago, it attempted to invoke preemption with respect to traditional telecommunications services (such as telephone service). In *Nixon*, the Court considered whether the FCC could use § 253 of the Communications Act to preempt a Missouri law that prohibited municipalities from providing telecommunications services. In an opinion authored by Justice Souter, the Court concluded that Missouri's ability to determine whether its municipalities could provide such services was part and parcel of the "traditional state authority to order its government." [541 U.S. at 130] It therefore decided that the clear statement rule—if Congress wishes to allow the federal government to preempt the States' historic powers, it must make its intent "unmistakably clear,"—applied. [*Gregory v. Ashcroft*, 501 U.S. 452, 460 (1991)] It further held that § 253 didn't satisfy it (despite explicitly mentioning preemption), and thus reversed the FCC's judgment.

Unusually, President Obama himself weighed in on this issue earlier this year. In Cedar Falls, Iowa, where municipal broadband is being offered by Cedar Falls Utilities, he stated that "if there are state laws in place that prohibit or restrict these community-based efforts, all of us—including the FCC, which is responsible for regulating this area—should do everything we can to push back on those old laws." [Remarks of the President on Community Broadband (Jan. 14, 2015), *available at* https://www.whitehouse.gov/the-press-office/2015/01/14/remarks-president-promoting-community-broadband].

The President's position makes it all the more striking that the U.S. Department of Justice refused to sign on to the FCC's brief defending preemption to the Sixth Circuit. It's also notable that just a few weeks after the President's statement, Cedar Falls Utilities and several dozen other municipal broadband providers urged the FCC to reject the President's proposal to impose common-carrier Internet regulation on them.

Mr. Stephens: David, the *amicus* brief NGA filed with the Sixth Circuit argues that § 706 doesn't provide the FCC authority to preempt state laws. Can you briefly explain that argument?

Mr. Parkhurst: Section 706 is not a grant of federal preemptive authority, but rather a general exhortation to federal *and state* regulators to encourage the deployment of advanced telecommunications capability to the public. For instance, the use of "and" between "Commission" and "each State [public utility] commission" in § 706 signals congressional intent for *shared* jurisdiction over matters involving advanced telecommunications services. With this simple conjunction, Congress established the states as partners with the Commission and gave them the same instructions to encourage deployment of advanced communications services.

Section 706 is a clear instance of collaborative federalism whereby both federal and state regulators work to promote the deployment of advanced communications. The Commission even admits in its Order that "we do not read Section 706 to itself preempt state laws."

Essentially, the Commission argues that while the statutory language prohibits preemptive authority under the Act itself, it does not prevent the Commission from *inferring* authority to preempt because of its aggressive reading of "other regulatory methods" in § 706. This is an overly-broad interpretation of its regulatory power under § 706 and contextually inconsistent with the full statutory passage.

The Commission's arguments for preemption are an abuse of discretion because the Commission's decision ignores the plain language of § 706, the Act's unambiguous statement that implied authority to preempt is prohibited, and the Act's legislative history.

Mr. Stephens: What are the broader implications for the doctrine of federal preemption if the Sixth Circuit upholds the FCC's reading of preemptive authority under § 706?

Mr. Parkhurst: The courts remain ground zero for deciding the constitutional line between federal and state authority. Upholding the Order would signal to other unelected federal agencies and departments a green light to pursue agency preemption of state laws where, like here, Congress has not granted express or implied authority.

Mr. Stephens: NGA's brief also places states' regulatory authority over municipal broadband into the context of those services' "history of overpromising and under-delivering." Can you offer a few examples for us here?

Mr. Parkhurst: We highlight several in our brief: Groton, Connecticut is an example of a failed municipal system that collapsed because the projected customer base, revenues, new jobs, and ability to compete with incumbent Internet providers failed to materialize. Groton sold its network for $550,000—a loss of over $30 million. The city and its taxpayers will have to pay $27.5 million in bond debt over the next fifteen years.

Burlington, Vermont began offering residents and businesses access to its municipal-broadband network deployed originally for exclusive use by city agencies in 2005. After securing millions of dollars in financing, the municipal system seemed poised to succeed, but by 2008, revenues did not cover debt payments and, by 2009, the system's debt load led the city council to conclude that the system was "too deeply indebted to break even." The Burlington system remains in debt and continues to struggle to expand its user base.

Mr. Stephens: Commissioner Pai, what does this Order tell us about the current Commission's perspective on federal regulation of the Internet in general?

Commissioner Pai: Unfortunately, I believe the Order, and subsequent statements defending it and promoting government-run broadband, indicate that the current Commission gives short shrift to federalism and other legal constraints on the agency's authority. Because the Administration's current policy is to promote publicly-owned and operated broadband, the law is seen as an impediment to be ignored, rather than a restriction to be respected.

More generally, pairing this Order with the Commission's net neutrality decision, the reasonable inference is that the agency's goal is greater government involvement in the digital economy, from the "who" (public entities as the federal government's preferred broadband provider) to the "what" (how any broadband provider, big or small, public or private, should be allowed to manage that network). This is a stark break from the two-decade-old consensus,

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dating back to the Clinton Administration, that the government should "preserve the vibrant and competitive free market that presently exists for the Internet and other interactive computer services, unfettered by Federal or State regulation." [47 U.S.C. § 230(b)(2)] And it puts America's longstanding leadership in the online world at risk.

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Mr. Stephens: Mr. Parkhurst, Commissioner Pai, thank you for joining us in this conversation.

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Jay B. Stephens serves as the Chairman of Washington Legal Foundation's Legal Policy Advisory Board. He recently retired from Raytheon Company after serving for nearly 13 years as Senior Vice President, General Counsel, and Corporate Secretary, and as a member of the company's senior leadership team. Prior to joining Raytheon, Mr. Stephens had a distinguished career in the public and private sectors, serving as Associate Attorney General of the United States (2001-2002); United States Attorney for the District of Columbia (1988-1993); Deputy Counsel to the President of the United States (1986-1988); Deputy General Counsel of Honeywell International; and as a partner in the Washington office of a national law firm.

The Honorable Ajit Pai was nominated to the Federal Communications Commission by President Obama in 2011. He was unanimously confirmed by the U.S. Senate and took office in 2012 for a term that concludes in 2016. Commissioner Pai previously served in the FCC's Office of General Counsel; at the U.S. Department of Justice's Antitrust Division and Office of Legal Policy; at the U.S. Senate Judiciary Committee; and as a law clerk to a federal judge in New Orleans. In the private sector, Commissioner Pai was a partner in the communications practice of the law firm Jenner & Block and worked as Associate General Counsel at Verizon Communications, Inc.

David Parkhurst serves as General Counsel and Staff Director for the National Governors Association. He is responsible for general legal matters for the Association and he staffs NGA's legal affairs committee, filing *amicus* briefs in federalism and preemption cases before federal and state appellate courts and the U.S. Supreme Court. His principal policy portfolio includes economic development, transportation and infrastructure, public finance, financial services regulation, and trade and investment.