

The Case **Against** Municipal FTTx:

What If It Was All A Great Big Lie?

Municipal broadband loses money in Memphis. The city refuses more funding.

By David P. McClure ■ *President, US Internet Industry Association*

The Memphis City Council last month refused to put more money into Networx, the public/private broadband company it started in 1999. The Council voted not to approve another \$6 million in funding guarantees for the telecom/Internet service, which has chewed through \$32 million. Networx CEO Mark Ivie told the council that the company will turn a profit soon. “Sometime towards the end of this year, the revenues that we generate will cover our expenses,” said Ivie.”

But Networx, 83 percent of which is owned by Memphis Gas, Light & Water, refused to open its books to the city. MLGW President Joseph Lee claimed that Networx (www.memphisnetworx.com) had lined up private investment instead, but that the city’s stake would fall to 48 percent unless it put more money in, too.

“There’s no impact whatsoever. We already have the guarantees in place from the private investor group,” said Ivie. At press time it was unclear whether outside investment is actually available without the city’s guarantee or new funds. Networx started as a cable distributor and added data two years ago. The Memphis *Commercial Appeal* reported that financial statements it reviewed showed losses at the company grew steadily from 2001 through 2003, with costs for connecting new customers nearly twice as much as the revenue it received from them in that period.

You won’t read about the trouble at Memphis Networx in *USA Today*. PBS won’t feature it in a prime-time special.

The pro-muni blogs won’t utter a peep about it. Memphis will simply join other municipal telecommunications networks that have quietly slipped away or are struggling on life support.

Even the failure of one such network should give taxpayers and ratepayers a case of the nervous willies. But the history of muni networks to date should cause any reasonable person to take a long, hard look at the numbers before committing the future of the hometown to a high-risk venture with a strong possibility of failure. Certainly, residents in Lafayette, LA, ought to be doing so – the Parish Council there is set to pledge the city’s assets on the gamble. If anything – any little thing – goes other than projected, the city and its residents lose everything.

Where’s the Openness?

Lack of profit isn’t the only characteristic that Memphis Networx shares with other municipal networks. There is also the web of deceit that surrounds their formation, and the refusal of their managers to share financial data with the taxpayers and ratepayers whose money they take.

Memphis City Council member Tajuan Stout Mitchell said she might have approved more money for Networx, but the utility refused to make public the financial statements for Networx. The company said such public disclosure would hurt Networx competitively.

This isn’t new. Nearly all municipal networks go to some lengths to hide their true financial picture. The Bristol, Virginia utility (BVU) that operates OptiNet tells members of the public they

will have to sue if they wish public access to data about the network they pay for – while raising cable rates by 12 percent, water bills by 22 percent and power bills by a whopping 40 percent in the past year. BVU management has quietly lobbied the Virginia legislature for a bill that would exempt it from reporting its financials forever. So far the state has refused.

Why is this happening? When municipal communications networks have been in operation for as much as a decade, why are current feasibility studies still being crafted with optimistic guesswork, spit and bubble gum? Why are there no hard numbers on which to base real and measurable goals and benefits? Why are taxpayers in cities that are considering such networks being shoved nonsense about business development and healing the Digital Divide – with absolutely no data to support these claims – in place of real and substantive financial data?

The answer: If taxpayers and ratepayers got a glimpse of the real numbers behind these operations, the politicians and paid consultants who are pushing these networks would be tarred and feathered, then run out of town on a rail.

If we accept that fiber networks are the future (and that is a major assumption, given that the technologies of broadband turn over every 3-5 years), and that the goal must be to bring affordable, advanced broadband services to every home and business in America as quickly as possible, it is still a major stretch in credibility to think that the only way to achieve the goal is to push municipalities to take a flyer in the high-risk telecom business.

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It is even more of a stretch once we realize that the justifications for municipal fiber networks, as stated in the feasibility studies and made public, are unsupported speculation. It would take too much space to catalog the long and growing list of the lies in a single article, but here is a representative sample:

Municipal networks are necessary because private companies have failed to bring broadband to the people. This might have been true in the last century, but today there are no businesses and few homes that are not served by phone lines, cable, satellite or cellular broadband. Cable alone reaches some 94.6 percent of all US households. And the services are, at least at the basic levels, affordable both at business and residential rates. DSL is now available for as little as \$14.95 per month. Cable TV starts at \$13 per month in most of the nation, cable Internet averages about \$35 per month. Satellite service is a bit higher, but reaches the nooks and crannies that wires can't yet reach. The claim that major cities, especially the size of Memphis, are somehow "underserved" to the extent that they justify creation of government monopolies is utter nonsense.

Municipal networks will bring competition to the marketplace. Governments don't create competition; they create monopolies. Municipalities drive competition out of the marketplace. Sadly, this generally occurs in markets

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where healthy competitors already exist and where service is expanding. In Lafayette, for example, city plans for a municipal fiber network will drive out more than a dozen broadband providers, including a private wireless mesh network that covers the entire city. There are no municipal fiber networks on record that have not sought to become the monopoly provider for the community.

Municipal networks will help to close the Digital Divide. This is one of the cruelest lies, because it leads thoughtful and well-intentioned citizens to believe that they are helping their neighbors. Sadly, there is no evidence that broadband will have any impact. This is because the Digital Divide is largely caused by other factors – illiteracy, lack of training, lack of computers and lack of technical support among them. If Internet access alone could heal the Divide, it would have already been accomplished through public networks in libraries and community centers, and through free dial-up accounts (which, while slower, do everything on the Internet most users need today).

Municipal networks will spur business development. So where is the data to prove it? Such a claim is relatively easy to measure, both in terms of new private jobs created and increases in median income levels. But the data doesn't support this claim – in general because virtually every company in every city in America can already get broadband from a number of vendors. What might have

been an incentive to move a decade ago is no longer, and most companies only go through the expense of relocating if they receive a major financial advantage – such as a break on city taxes.

Municipal networks will pay for themselves and generate revenue. This lie is based on two major assumptions – first, that the municipal network will quickly eliminate competition and gain a major share of the market, and second that they are able to price their products favorably. Neither has proven the case. The problem is both competition and economies of scale. If the municipal networks are successful in spurring competition, they are not able to amass sufficient market share to avoid failure. Where they do amass the market share, they are still a small fish in a large pond, with insufficient size to be able to exert the cost controls and market power of larger private companies that have millions of subscribers.

Final Thoughts

The arguments set forth to justify building municipal fiber networks have strong emotional appeal. They speak to underserved communities; of people left behind in the great Information revolution; of better services and lower costs. But like the campaign promise of a “chicken in every pot,” these arguments are rhetoric rather than reality.

The decision by a municipality to enter into the highly fragmented, high-risk communications industry – one that suffers from high churn rates, technology

turnovers every 3-5 years, high fixed costs and extremely high capital investment requirements – should not be taken lightly. It should be taken only following a careful analysis using real numbers. Even then, it should be undertaken only with the support of the community, particularly the taxpayers and ratepayers who will have to shoulder the risk and the expense if the venture fails.

The American Legislative Exchange Council, a non-partisan organization of 2,400 current and former state legislators, has proposed model legislation that states may adopt to ensure that consumers are protected as cities consider municipal networks. The ALEC model legislation calls for municipalities to conduct open hearings; to conduct feasibility studies; to hold for a vote of the people before making a decision; and to ensure open disclosure as the project moves forward.

The legislation has been attacked by pro-muni advocates. Labeled “pro-monopoly” or “pro-Bell,” this legislation has even faced opposition in the media. Nonetheless, a majority of states have passed or are considering such legislation.

Advocates of municipal fiber networks say that such networks are necessary; that they are created out of need; that they will fill important roles for social and economic improvement; that they will help residents meet their most pressing requirements for the future.

But what if it is all a great, big lie?

What if, instead, the municipal networking story is one of a cabal of self-interested equipment manufacturers and consultants duping cities into building expensive, doomed “white elephant” networks? And what if, sadly, we have known all along that these networks were the wrong thing to do because the evidence and the facts show it plainly to anyone who took a realistic and impartial look at the data? ♦

About the Author

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