

**Governmental Participation in
Telecommunications Services:**

A Vital Link to Economic Development

**A Policy Paper from the
Illinois Municipal Utilities Association**

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Why does local government need the ability to offer telecommunication services?

Municipalities across Illinois have long offered a variety of utility services to their residents. Most of the services units of local government offer are not attractive to for-profit companies. Providing water and waste water services, as an example, are necessities of life but not highly sought after by private firms.

Some units of local government have also offered services for which there eventually were alternatives in the private market. For the better part of a century 42 municipalities in Illinois have operated successful electric utilities. More than 60 operate their own natural gas distributions systems. Communities entered into these enterprises because they either were not being offered to their citizens, or the level of service was not deemed sufficient by the communities' citizens. These local governments are well versed in providing life critical services safely, reliably, and economically.

Today, a fresh focus for many municipalities is the need for advanced telecommunications services. As in the past, many communities in Illinois have determined that they are being underserved in an area that has become a necessity for business and industry. Large incumbent telecommunications providers often cannot make a business case for making the needed investments and offering the services communities have determined are necessary for their purposes. Such business decisions are reasonable if the company does not believe it can recover an appropriate return on its investment.

But having available high-speed telecommunications services at a good cost today is comparable to a community having access to a variety of good transportation alternatives. Without high-speed telecommunications, just as without good air service or a nearby interstate, industry will simply bypass a community. Absent such services, existing businesses may also leave, or take expansion plans elsewhere.

That is why, to insure that their communities have the telecommunications services they need, a number of municipalities in Illinois have undertaken offering a variety of such services. Others are considering offering such services. A listing of some of these communities is provided later in this paper.

In summary, Illinois communities are offering telecommunications services primarily to spur local economic development - that is, they are putting in the needed infrastructure themselves and, when necessary, providing telecommunications services themselves as an investment in their communities' future. They see this as an investment in new industry, new good paying jobs and an increased tax base.

What is the current law in Illinois on municipalities engaging in telecommunications activities?

The authority of Illinois municipalities to acquire, construct, own and operate municipal utilities and to provide services in connection therewith dates back to the Municipal Ownership Act of 1913 (“Ownership Act”). Ill. Rev. Stat. 1913, ch. 111a, par. 87 (now known as 65 ILCS 5/11-117-1); Springfield Gas & Electric Co. v. City of Springfield, 292 Ill. 236, 244-45, 126 N.E. 739, 743 (Ill. 1920), aff’d 257 U.S. 66 (1921). This authority included the power to own, operate and provide services from plant, equipment or property used for or in connection with the conveyance of telegraph or telephone messages, in addition to the provision of electric, natural gas, water, wastewater, transportation of persons or property, warehousing and wharfing services. 65 ILCS 5/11-117-2(1).

The General Assembly enacted the Ownership Act contemporaneous with what is now the Public Utilities Act (“PUA”) as an apparent political compromise whereby the Commission would regulate privately-owned utilities, but municipalities would self-regulate and fix rates for their own utilities. This law originally appeared in the Illinois Revised Statutes as part of the PUA, but the legislature was later reenacted and moved it into the Revised Cities and Villages Act in 1941. In 1961 the General Assembly revamped and renamed the Revised Cities and Villages Act the Illinois Municipal Code (the “Municipal Code”) and included the provisions of the Ownership Act within the new Municipal Code. Ill. Rev. Stat. 1963, ch. 24, par. 11-117-1 *et seq.* These provisions still reside in the Illinois Municipal Code today. 65 ILCS 5/11-117-1 *et seq.*

Up until the enactment of the Universal Telephone Service Protection Law of 1985 (the “1985 Telephone Law”) the Illinois Commerce Commission had no regulatory or supervisory authority over telecommunications activities by Illinois municipalities. The 1985 Telephone Law, which created Article XIII of the PUA, expanded the Commission’s statutory authority over municipally-owned and operated telecommunications carriers by including them within the term “telecommunications carrier” if those carriers provide telecommunications services for other than “their own use.” Ill. Rev. Stat. 1985, ch. 111 2/3, § 13-202. In other words, if a municipality provides telecommunications service solely for its own use, then the Commission has no jurisdiction over that carrier. If, however, the municipality seeks to offer or offers telecommunications services to private consumers or other governmental entities, the Commission has jurisdiction over the municipality and it must obtain certification before offering service.

Aside from the limited introduction of Commission authority, municipal power to own and operate public utilities, including the conveyance of telegraph or telephone messages, as found in the Illinois Municipal Code, remains relatively unchanged in the

90 plus years since the enactment of the Ownership Act. A municipality may own and operate a public utility that provides telecommunications services not only for its own use, but also to private consumers and governmental entities other than itself.

To own and operate a municipal utility, the municipality must first pass an ordinance, describing the proposed utility and how it will be financed, and then obtain the approval of its voters through referendum. 65 ILCS 5/11-117-3 & 11-117-4. After obtaining initial voter approval via referendum, the municipality is free to expand its utility service offerings to consumers located beyond its corporate boundaries so long as the municipality's governing body approves such action and a major portion of utility services remain supplied or sold within its corporate boundaries. The referendum requirements of 65 ILCS 5/11-117-3 and 11-117-4 do not apply to home rule municipality under the provisions of the Illinois Constitution .

Before offering services, the municipality is required to fix rates for services that are sufficient to bear all cost of maintenance and operation and to meet interest charges on bonds and certificates issued to acquire, construct or operate the utility, and permit the accumulation of a surplus or sinking fund to meet all unpaid bonds or certificates at maturity. 65 ILCS 5/11-117-12 To ascertain its costs and set sufficient rates, a municipality must keep separate accounts for each utility operation distinct from other municipal accounts in accordance with generally accepted accounting principles (GAAP). 65 ILCS 5/11-117-13. Each account must detail: (1) the actual cost of the municipality of each public utility owned; (2) all costs of maintenance, extension and improvement; (3) all operating expenses of every kind; (4) amounts set aside for sinking fund purposes; (5) reasonable allowances for interest, depreciation, and insurance; and (6) estimates of the amount of taxes that would be chargeable against each public utility if owned by a private corporation. The rates charged by a municipally owned utility are generally subject to challenge as unreasonable or discriminatory and are reviewable in the circuit court.

The authority of Illinois municipalities to engage in telecommunications activities was reviewed by the Staff of the Illinois Commerce Commission in ICC Docket No. 03-0779 involving the City of Naperville. A summary of the Commission Staff's review was set forth in the Commission final order (pp. 16-18) granted a certificate of service authority to Naperville in that docket. The Commission Staff concluded in their review that municipalities must not only operate a telecommunications utility with popular consent, but also in a fiscally-sound manner that accounts for its actual costs and includes certain costs experienced by privately-owned utilities according to Generally Accepted Accounting Principles.

Municipal telecommunications activities and the question of fairness.

Objections to municipal telecommunications activities have tended to focus on alleged or perceived advantages held by units of local government in relation to private providers. The two issues most commonly cited concern municipal access to tax-exempt finance and so-called cross subsidization. Let us briefly address each.

Tax-exempt finance: Access to tax-exempt finance is undeniably an advantage for units of local government. However, it is not an unfair advantage and is balanced by disadvantages inherent in being a governmental entity and advantages held by private telecommunications providers.

Tax-exempt finance is a long-standing method used by units of government to finance infrastructure. It is part and parcel of operating a governmental not-for profit system, as units of local government do not have shareholder investments or profits from which to draw.

In addition, municipal utilities operated by units of local government are subject to a number of laws restricting their activities. The Open Meetings Act, the Freedom of Information Act, state ethics law and elections laws all place restrictions on municipal systems that are not placed on private firms.

As an example, restrictions on what municipal officials can and cannot say in support of ballot initiative are a significant restriction on units of local government. Such limitations give private firms a great advantage when they choose to oppose referenda as they go before the voters.

On balance public and private entities each have advantages and disadvantages that generally offset each other.

Cross-subsidization: Municipal systems would agree that cross subsidization should not be allowed if it is defined as using funds from one municipal account and moving them into a telecommunications entity with the intent of offering services at below cost. We do not believe that such cross-subsidization is allowed under current law and would not support such activities.

However, we do not believe that using the billing department of an existing municipal utility (water, waste water or electric for example) to perform billing or accounting functions for a municipal telecommunications system is an example of cross subsidization. Private entities use such synergies to expand their offerings by using excess capacity. Using our billing departments is no different.

What some communities are doing in the telecommunications field.

As previously noted, a number of Illinois communities are either offering telecommunications services, putting the infrastructure in place to offer such services or actively planning to offer such services, in general, as a matter of local economic development. These are a few of the communities that have made or are making significant investments in telecommunications infrastructure to further their communities' economic development efforts.

Springfield: The City of Springfield provides high-speed data transfer and connectivity to internet points of presence (POP), including the Century Illinois Network. All services are provided under the city's Contract Service Tariff. The City holds a certificate of service authority from the Illinois Commerce Commission for the services it provides and is a Competitive Local Exchange Carrier (CLEC). They have the authority to provide all types of telecommunications services, although they have no plans to extend service into telephony at this time.

St. Charles: St. Charles operates approximately 50 miles of fiber-optic backbone with about 50 customers connected and using the system. Services provided include high-speed internet access, computer Wide Area network, voice over internet protocol (VOIP), system control for municipal electric and water systems, fire alarm and other communication functions. The customers consist of city facilities, all the District 303 school facilities, and some county offices.

St. Charles was granted a certificate of service authority from the Illinois Commerce Commission for the services it provides and is a Competitive Local Exchange Carrier (CLEC). Its plans include extension of the fiber network to the premises of industrial and commercial customers.

Rochelle: The City of Rochelle has been providing internet service to its citizens since 1996, again because offering that service at the time was not in the business plan of the city's incumbent service provider. Since that time the city has rolled out progressively more advanced systems and currently has a fiber-optic network with fiber available to the premises. Wireless internet service has also been provided since 2001. Rochelle has received a certificate of service authority from the Illinois Commerce Commission for the services it provides and is a Competitive Local Exchange Carrier (CLEC).

In addition, Rochelle is working with other governmental entities, including the Department of Transportation, Northern Illinois University and the City of Rockford to extend an existing fiber-optic network in northern Illinois. This will

create a Northern Illinois Technology Triangle that will allow communities to improve the quality of life, stimulate their economies and grow their tax bases.

Princeton: Several years ago, after the loss of major employer (Harper Wyman Corning) and concerns expressed by remaining industry, Princeton approached its incumbent service providers to secure high-speed data services. The incumbents could not make a business case for providing such services, and therefore the city council took it upon itself to move ahead. Princeton has received a certificate of service authority from the Illinois Commerce Commission for the services it provides and is a Competitive Local Exchange Carrier (CLEC).

Princeton has installed 15 miles of fiber-optic infrastructure which is ready to be extended to customers. Actual services will be provided not by the city, but by the private firm of Connecting Point of LaSalle, Illinois under contract to Princeton. The city will maintain the infrastructure and receive a return on its investment. Four customers have already arranged for a fiber connection.

The city is also putting into place a pilot program to test Broadband Over Powerline (BPL) technology. This system will be attractive to smaller business and residential customers who do not need the bandwidth that fiber provides.

Batavia: Similar to St. Charles, Batavia has received a certificate of service authority from the Illinois Commerce Commission for the services it provides and is a Competitive Local Exchange Carrier (CLEC). It operates a fiber optic network to assist its various utility functions.

Geneva: Similar to St. Charles and Batavia, Geneva has received a certificate of service authority from the Illinois Commerce Commission for the services it provides and is a Competitive Local Exchange Carrier (CLEC). The city operates approximately 25 miles of fiber serving all its electric substations, all city sites, all Geneva School district sites, and many Kane County sites. (Geneva is the Kane County seat.) The city provides a managed point to point gigabit internet protocol network for the Geneva School District, as well as a managed point-to-point gigabit internet protocol network for all City of Geneva Sites, a point-to-point dark fiber lease to seven Kane County sites within Geneva, and a physically separate fiber network for their electric utility.

Both the City of Geneva and Kane County operate Cisco IP PBX Phone systems across Geneva's fiber. The City of Geneva operates approximately 200 phones, while Kane County runs about 1,200 phones across the fiber. The county also operates a fiber optic network to assist its various utility functions.

Rock Falls: Rock Falls operates a fiber loop around the city, which is currently used for vital utility functions. It also is the backbone that links the city's various departments, including city hall, the police and fire departments. It is also being

used by the schools, through the Illinois Century Network, to provide high speed internet services to the schools (as does Springfield). Rock Falls, as the others, has received a certificate of service authority from the Illinois Commerce Commission for the services it provides and is a Competitive Local Exchange Carrier (CLEC).

The city's future plans include participating in the northern Illinois fiber optic network (see Rochelle) and are examining offering high speed internet service by fiber optic facilities to industrial and commercial customers with initial design work currently being undertaken.

Naperville: As with St. Charles, Batavia and Geneva, Naperville has received a certificate of service authority from the Illinois Commerce Commission for the services it provides and is a Competitive Local Exchange Carrier (CLEC). It operates a fiber optic network for vital utility functions.

Sullivan: The City of Sullivan surveyed their customers two years ago and found a significant level of dissatisfaction with the incumbent service providers. DSL, for instance, is still not available in the city. The city currently operates a wireless internet system for its municipal use only but plans to move that service to a fiber-optic network once that infrastructure is complete.

This is not a complete listing but provides an overview of the types of activities that are ongoing.

Local Government and the Future of Telecommunications Law in Illinois

As we have noted in this paper, a number of Illinois communities have taken it upon themselves to offer a variety of telecommunications services and others are examining their options. The investment to date by the communities is in the millions of dollars and has been done within the bounds of existing law and for the reasons we have outlined.

As the Illinois General Assembly approaches the rewrite of the state's telecommunication laws, units of local government ask respectfully that they continue to have the legislative authority to provide telecommunications services.

Incumbent telecommunications service providers certainly have the right to make business decisions about where to invest their shareholders money. That includes their right not to put in facilities that, in their judgment, may not provide a timely return on investment.

However, municipalities should not be bound by the business decisions or timetables of private telecommunications providers if there is the community will to act on its own. If municipalities decide to install the necessary infrastructure and engage in telecommunications endeavors as a tool for economic development they should be able to do so. If they wish to install the needed infrastructure and provide it for use by private entities with the appropriate return on investment for their citizens they should also be able to do so.

In Illinois, municipalities are demonstrating that they can be incubators for advanced technologies. The new information highways they are helping to create may well bring new industry, new jobs and new tax base not just to the communities themselves, but to the state as well.

Illinois' municipalities do not ask for special treatment under the law. They are subject to the same laws that apply to other telecommunications providers and must meet substantially the same standards in addition to others specific to them. By the same token, they should not be subject to special restrictions that place a burden on them beyond those that currently exist. Erecting new barriers to municipal entry in these services will choke off much promising and valuable activity.

In summary, units of local government welcome working with private telecommunications providers when possible. But private providers should not hold a veto over the ultimate authority of municipalities to engage in telecommunications activities.

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About the Illinois Municipal Utilities Association -

IMUA is a not-for-profit corporation functioning as a trade association for municipalities that own and operate their own electric, natural gas, water, wastewater and telecommunications systems in Illinois. It is composed of 74 municipalities, 13 affiliate members and 67 associate members.

IMUA is governed by a 15-member board of directors drawn from its member municipalities. The board makes all decisions relating to policies undertaken by the Association. A General Manager and CEO administers day-to-day operations. The IMUA is financed through dues collected from its members, those dues being proportional to utility sales, and from fees associated with its training activities.