I. History[1]

1868: The "Dillon Rule," declaring that political subdivisions of a state have only those powers expressly granted by state law or necessarily implied from express powers, is first articulated in the Iowa case of *Merriam v. Moody's Executors*[2]. Virginia is a Dillon Rule state[3], which implies that a local government's powers must be interpreted in the strictest sense.

1996: In an effort to develop competitive markets for telecommunications, Congress enacted into law a statute to remove barriers to entry, containing the following language[4]:

> *47 USC §253: "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."* (emphasis added)

1998: The Virginia General Assembly enacts HB 335[5], amending § 15.2-1500[6], which prescribes that no locality shall establish any governmental entity which has authority to offer telecommunications equipment, infrastructure or services. Exceptions are provided for certain intra- and inter-governmental uses and for the Town of Abingdon (described by proximity to Interstate 81). Localities are permitted to sell their existing telecommunications infrastructure and equipment. The act contains a sunset clause of July 1, 2000.

1999: The General Assembly enacts HB 2277[7], amending § 15.2-1500, adding a provision allowing a locality, electric commission or board, industrial development authority, or economic development authority to lease dark fiber (but *not* provide services) upon approval by the State Corporation Commission. The act specified the conditions governing the SCC's

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[1] This section is an elaboration of concepts presented in the Baller & Herbst Law Group's presentation to The Virginia Association of Telecommunications Officers and Advisors (VTOA) on April 8, 2003. Online: http://www.baller.com/pdfs/vatoa-4-8-03.pdf. For a more general, comprehensive discussion of the legal and policy implications of municipal broadband, see http://www.baller.com/library.html

[2] For a discussion of the difference between the powers of local government in"Dillon's Rule" and "Home Rule" states, see Baller and Stokes' paper in the Journal of Municipal Telecommunications, http://www.munitelecom.org/v1i1/Baller.html

[3] See Article VII, Section 2 of the Constitution of Virginia, http://legis.state.va.us/Laws/search/Constitution.htm#7S2

[4] Summary provided by Jim Bowie, in an earlier paper on this site: (http://www.ecorridors.vt.edu/research/papers/topic/?paper_id=2)

[5] For full text of HB 335, see http://leg1.state.va.us/cgi-bin/legp504.exe?981+ful+CHAP0906

[6] For full text of § 15.2-1500, see http://leg1.state.va.us/cgi-bin/legp504.exe?000+cod+15.2-1500

[7] For full text of HB 2277, see http://leg1.state.va.us/cgi-bin/legp504.exe?991+ful+HB2277ER

decision, relating to the likelihood of the lease's promotion of competition and economic development, the presence of private providers, and the likelihood of the lease's benefiting consumers. Furthermore, the July 2000 sunset clause introduced by the 1998 legislation was repealed.

2001: The *Bristol v. Earley*[8] decision was handed down by Judge James Jones in U.S. District Court in Abingdon. Jones declared § 15.2-1500 unenforceable and preempted by the Telecommunications Act of 1996, § 253(a):

> "[n]o 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." 47 U.S.C.A. § 253(a) (emphasis added).

This decision was rendered moot by the enactment of SB 245, as described below.

2002: The Virginia General Assembly enacts SB 245[9], amending § 15.2-1500 and § 15.2-2160[10] of the Code of Virginia, authorizing localities that operate electric utilities to provide telecommunications services upon the granting of a CLEC certificate from the State Corporation Commission pursuant to § 56-265.4:4[11] This is referred to as the "CLEC/MLEC option." Alternately, a locality that does not obtain a certificate to provide telephone services may offer qualifying telecommunications services, including high-speed data service and Internet access service, upon application to the SCC. This is referred to as the "Significant Gap" option. SB 245, as an explicit grant of power to localities, superseded the restrictions of § 15.2-1500 and ended litigation in the *Bristol v. Earley* case.

2002: The case of *Marcus Cable Associates, LLC v. Bristol*[12] was decided in District Court in Abingdon (incidentally, by the same Judge James Jones who wrote the opinion in *Bristol vs. Earley*.) Marcus Cable Associates, LLC, d/b/a Charter Communications, contested Bristol Utilities' legislative authorization to provide cable TV service on their fiber-optic network whose operation had been permitted by SB 245. Judge Jones ruled in favor of Charter, on the grounds that Bristol lacked an express grant of power to offer cable service and was therefore prohibited from doing so by the Dillon Rule. The court also found that since Cable Television was not considered an "essential" service, it was not a "public utility of the sort that the City was authorized to provide by state law or its own charter.

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[8] For full text of *Bristol v. Earley*, see http://www.vawd.uscourts.gov/OPINIONS/JONES/CITY.PDF
[9] For full text of SB 245, see http://leg1.state.va.us/cgi-bin/legp504.exe?ses=021&typ=bil&val=sb245
[10] For full text of § 15.2-2160, see http://leg1.state.va.us/cgi-bin/legp504.exe?000+cod+15.2-2160
[11] For full text of § 56-265.4.4, see http://leg1.state.va.us/cgi-bin/legp504.exe?000+cod+56-265.4C4
[12] For full text of *Marcus Cable Associates, LLC v. Bristol* see http://www.vawd.uscourts.gov/OPINIONS/JONES/1-02CV00197.PDF

2003: The State Corporation Commission publishes the Rules governing CLECs/MLECs[13].

2003: SB 847[14], amending § 56-484.7:1[15], § 56-265.4:4 and §15.2-2108 of the Code of Virginia, was enacted by the General Assembly. It was sponsored by the same Sen. William Wampler (R, Bristol) who sponsored SB 245 and serves a similar purpose: to create an explicit statutory grant of power in response to a Dillon's Rule challenge in the courts (in this case, *Marcus Cable Associates, LLC v. Bristol*). This act creates a statutory procedure for cities and towns that operate a municipal electric utility and obtain a certificate to operate as a telephone utility to offer cable television services. Bristol was granted authority to provide cable television services by this act (rendering *Marcus* moot), and was exempted from most of the act's restrictions and conditions (covered in the "Implications" section).

2003: HB 2397[16], amending §§ 56-235.5, 56-265.4:4, 56-484.7:1, 56-484.7:2, and 56-484.7:4 was enacted by the General Assembly. It prescribed more detailed rules for the SCC's regulation of CLECs/MLECs, and outlined procedures by which localities not operating under a CLEC certificate could petition the SCC to provide "qualifying communications services" HB 2397 also required localities in the latter category to offer private providers nondiscriminatory access to their facilities, prohibited them from offering services at rates below those of the incumbent private provider, and prohibited them from using their power of eminent domain to acquire facilities.

2004: On January 12, 2004, the case of *Nixon, et al., v. Missouri Municipal League*[17] was argued before the U.S. Supreme Court. The case was remarkably similar to the familiar *Bristol v. Earley,* and is included in this discussion of Virginia law because it set an important national precedent. Briefly, the Missouri Municipal League (MML) represented the interests of a group of Missouri localities that had attempted to use Federal preemption under the Telecommunications Act of 1996 overturn a state statute that prohibited political subdivisions of the state from providing broadband services. The FCC refused to preempt the law, but the Eighth Circuit found in favor of the MML and reversed the FCC's decision. The FCC promptly petitioned the Supreme Court for certiorari, and was joined by the Missouri attorney general, Jeremiah Nixon, and the incumbent telecommunications provider, Southwestern Bell. The key points of law in question were whether "any entity" in the Telecommunications Act applies to a state's political subdivisions, and if so, whether Congress

[13] See http://www.state.va.us/scc/division/puc/417_clec.pdf
[14] For full text of SB 875, see http://leg1.state.va.us/cgi-bin/legp504.exe?031+ful+SB875ER
[15] For full text of § 56-484.7:1 see http://leg1.state.va.us/cgi-bin/legp504.exe?000+cod+56-484.7C1
[16] For full text of HB 2397, see http://leg1.state.va.us/cgi-bin/legp504.exe?031+ful+HB2397ER
[17] For full text of all the litigation in the *Missouri* case, see http://www.baller.com/library-missouri.html

meant to (or could) usurp state powers of regulation by enacting such a provision. Augmenting these core arguments were a dozen *amicus curiae* briefs, in which virtually every policy argument for and against municipal broadband was presented.

2004:

On March 23, 2004, the U.S. Supreme Court delivered their opinion[18] in the *Nixon, et al., v. Missouri Municipal League.* The Court ruled **against** the municipalities. They held that the phrase "any entity" in the Telecommunications Act "…does not include the State's own subdivisions, so as to affect the power of States and localities to restrict their own (or their political inferiors') delivery of telecommunications services. The Court's opinion stated that the phrase "any entity" failed the "plain-statement rule" established in *Gregory v. Ashcroft.* The Court pointed out numerous problems associated with Federal preemption in this case and insisted that the Congress could not have intended these results. For example, they noted that the grant of *authority* municipalities would receive under Federal preemption would not necessarily guarantee them the *ability* to provide the desired services, since the states still have regulatory power to circumvent the grant of authority (e.g., power of the purse). The court also noted that preemption would treat states differently depending upon their existing legislative structures – although as the "Implications" section of this paper notes, the absence of preemption still results in national inconsistency. It's important to realize, though, that the arguments in the opinion were based on these points of law; the Court noted that "the issue here does not turn on the merits of municipal telecommunications services.' Simply put, the Court paid very little attention to the policy arguments that were presented in the *amicus curiae* briefs. **Implications** of this decision for Virginia municipalities are discussed at the end of this paper.

[18] For full text of the Supreme Court's opinion in *Nixon, et al. v. Missouri*, see http://www.baller.com/pdfs/mml_sct_opinion.pdf

II. Policy Implications[19]

This section details the practical implications of the current regulatory environment in Virginia as of April, 2004. Many of the provisions of SB245 are still in effect, but new regulations have been introduced by the most recent legislation (SB 875 and HB 2397). Unless otherwise explicitly stated, all regulations apply to all municipalities in the Commonwealth of Virginia. The Dillon Rule is still very much in effect, so powers beyond the scope of those outlined here are understood to be withheld from localities.

- A locality *that operates a municipal electric utility* may apply for an MLEC license from the State Corporation Commission according to § 56-265.4:4 of the Code of Virginia and the Rules outlined by the SCC.
    - An MLEC must comply with all CLEC requirements outlined in § 56-265.4:4 of the Code of Virginia.
    - An MLEC must make "reasonable estimates" of costs (including taxes, fees, and ROW charges) that would be incurred if the locality were a private provider. In addition, the locality must release financial statements of its operations on an annual basis and maintain records documenting compliance with state law.
    - An MLEC must provide nondiscriminatory access to its facilities to for-profit providers on a first-come, first-served basis.
    - An MLEC must NOT cross-subsidize telecommunications operations with other local revenues UNLESS the SCC deems such a subsidy as being in the public interest *and* provided that such a subsidy does not allow the MLEC to charge a price lower than the price for the same service charged by the incumbent provider in the area.
    - An MLEC must NOT acquire by eminent domain the facilities or property of any other provider in order to provide telecommunications services.
    - An MLEC may provide services to any locality in the Commonwealth of Virginia in which it has electric distribution facilities - UNLESS:
        - *The locality was providing telecommunications services on March 1, 2002*, in which case the locality may provide telecommunications service within 75 miles of the geographic boundaries of its electric distribution system.
    - An MLEC may construct, own, maintain, and operate a fiber optic or communications infrastructure to provide consumers with Internet services, data transmission services, and any other communications service that its infrastructure is capable of delivering; however, the provision of Cable TV is not permitted by this section. The provision of cable TV is regulated by a separate (new) set of rules.

[19] Adapted from Baller and Stokes' presentations to the VATOA http://www.baller.com/pdfs/vatoa-4-8-03.pdf, and the National Regulatory Conference, http://www.baller.com/pdfs/present-may13.pdf

- A county, city, town, electric utility, industrial development authority, or economic development authority that is
    1. *Not eligible to provide telecommunications services as an MLEC* AND
    2. *Has a population of under 30,000*

  may offer Internet access, high-speed data service, and other "qualifying communications services" – but NOT cable TV (CATV is governed by a separate set of rules).
    - In this case, the entity desiring to provide services must petition the State Corporation Commission for the authorization to do so within a specified geographic area. The SCC is directed by statute to accept petitions unless the service to be provided is already available in the specified geographic area from three or more providers, or if the SCC deems that the entity's provision of the service will not benefit consumers, or if the petition itself is in violation of some other provision of the Act.
    - Localities that are granted permission to provide services in this manner:
        - Must provide nondiscriminatory access to their facilities to for-profit providers *unless the facilities have insufficient capacity*.
        - Must NOT set prices for services lower than that of any incumbent provider for a *functionally equivalent* service that is *equally available* from the incumbent and the governmental entity.
        - Must NOT acquire by eminent domain the facilities or property of any other provider in order to provide telecommunications services

Note that these implications only apply to the provision of telecommunications **services** to private customers. Nothing in this legislation is intended to limit the public operation of telecommunications networks for its own use (e.g., government operations, education, homeland security, etc.).

Also, there are other things a public entity can do short of directly providing services to customers, including the installation and subsequent lease of dark fiber to private providers, and the operation and management of an open-access fiber-optic network, to name a few. In these instances, the provisions of the law are less clear; certainly, however, it may be observed that as a general rule, there are fewer legal barriers to public intervention in telecommunications as the public entity becomes farther removed from the actual provision of service to customers.

The MLEC and Significant Gap provisions of law apply only to direct provision of services. If a public entity wanted to lease dark fiber to a private provider, they should not have to apply for MLEC status or demonstrate the existence of a significant service gap. If they wished to operate a managed infrastructure network, however (i.e., "lighting" the fiber and switching and routing the network traffic), the legal implications are less clear. More research is necessary here, and will hopefully be incorporated into a future version of this paper.

New Rules for the provision of Cable Television (CATV) to non-governmental customers[20]:

- The locality must first hold a public hearing
- The locality must then hire a consultant to conduct a feasibility study, considering:
  - Whether municipal provision of CATV will hinder or advance competition
  - Whether "but for" the municipality, CATV would be provided
  - The fiscal impacts of municipal CATV provision, in terms of both operating and capital expenses
  - Projected growth in demand for CATV within the municipality
  - Projections of the project's costs and revenues, calculated at the time of the study and five years into the future
- The locality's governing body will determine if the projected revenues exceed the projected costs by at least enough to meet the bond obligations.
- The locality must conduct a public hearing on the results of the feasibility study
- The municipality must conduct a referendum to decide whether or not CATV service will be provided
- Assuming the referendum is successful, the municipality must establish an enterprise fund for the CATV service and keep its operating and capital budgets separate from other municipal budgets
- The municipality may NOT transfer funds from other departments, but may "loan" funds from such departments at market rates. It may issue revenue bonds to cover capital costs.
- A municipality may not cross-subsidize its CATV services with tax dollars (or anything else)
- A municipality may not grant an unfair advantage to itself (or a private provider)
- A municipality must apply its own rules and policies to itself that it would apply to a private CATV provider
- Fees must be no more than the sum of direct costs, indirect costs, and the taxes, fees, etc. that the municipality would pay if it were a private provider.
- A municipality may only provide cable service in the area covered by its electric distribution system or by the extent of its telecommunications plant as of January 1, 2003
- A municipality may not use eminent domain in order to provide CATV service.
- A municipality must adopt an ordinance guaranteeing Quality of Service to its subscribers.
- A municipality providing CATV service is not immune to antitrust litigation.

[20] (Localities that had installed a CATV headend prior to December 31, 2002 (Bristol) are exempt from these new regulations)

- Implications of the *Nixon, et al., v. Missouri Municipal League* Supreme Court Decision:
    - The ruling in the case renders municipalities wishing to provide telecommunications services ineligible for Federal preemption of a state barrier-to-entry statute under the Telecommunications Act.
    - In states that have legislation prohibiting municipalities to provide telecommunications services, municipalities no longer have the legal recourse of preemption under the Telecommunications Act that allowed Bristol, VA. Utilities to prevail in 1997.
    - In states where no such "barrier-to-entry" legislation exists, the powers of municipalities are essentially unchanged; but if such a state later passed a "barrier-to-entry" statute, the municipalities would be denied the recourse of Federal preemption.
        - In home rule states whose legislatures have remained silent on the issue, municipalities have free reign to provide services at will.
        - In Dillon's rule states whose legislatures have remained silent on the issue, municipalities must seek explicit grants of authority to provide services.
    - In states where legislation explicitly *permits* municipalities to provide telecommunications services (**Virginia** falls into this category), the entities that were eligible to provide service before the decision will still be able to do so afterwards. However, the terms, eligible parties, etc, of municipal provision of telecommunications service in these states depends upon the restrictions placed on municipalities by the state law. (See the earlier discussion of specific Virginia law to get an idea of what kinds of restrictions are on the books here.) Furthermore, in states with grants of permission that are subject to terms and limitations, a municipality that is *excluded* from providing telecommunications service under these terms and limitations has no recourse to Federal preemption under the Telecommunications Act. In short, the route that Bristol took to win their litigation has now been closed off.
    - The decision in *Nixon, et al., v. Missouri Municipal League* does not significantly change the balance of power between states and localities. It simply re-affirms the status quo and denies municipalities the recourse to Federal preemption. As was the case before *Bristol* and *Missouri* changed the way people thought about municipal provision of telecommunications services, municipalities must look primarily to the States, and not the Federal Government, to obtain grants of permission to provide telecommunications services.

III. Limitations of this Paper

It should be emphasized that the scope of this paper is necessarily limited. As mentioned earlier, it covers only the provision of telecommunications **services** by **governments**. It therefore does not consider a number of policy options that have been discussed in this arena, including:

- Leasing of publicly-owned dark fiber to private providers.
- Public-private partnerships in which the locality owns and also operates/manages the network, allowing providers "open access" to the network.
- Provision of services or infrastructure by a nonprofit or other "entity" acting more or less on behalf of the locality.

These are important questions for further research, and may be covered as an addendum to this paper or as the topic of a separate one.

This paper is not a substitute for a legal opinion. It is the product of research conducted by the Virginia Tech eCorridors group, and though great care has been taken in attempting to ensure its completeness and accuracy, errors may still exist. Furthermore, the "Implications" of the legislation and case law are based on its interpretation by the Virginia Tech eCorridors group, and at the time of writing, have not been verified by legal counsel.