

Tie a Yellow Ribbon 'round the Old Utility

Spencer Takes on Cable Provider

Lawsuits Threaten System Roll Out

Utility Trades Cable for Citizen Support

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Yellow ribbons decorate homes and yards in Spencer, IA, but not because native sons are fighting in combat or someone is missing. The only war going on is between the municipal utility and the local cable company.

Cable provider Mediacom Iowa has filed suit against the city and Spencer Municipal Utilities (SMU), seeking an injunction to stop them from rolling out a \$17 million telecommunications system for the town of 11,000. A related citizen's lawsuit contends that electric ratepayers are being put at risk.

Opponents of the system argue that SMU plans to operate its system without a cable franchise, that the company illegally lent itself money and that the electric utility illegally borrowed money on behalf of its telecommunications affiliate in violation of a new Iowa state law.



Downtown Spencer, IA
Source: Spencer Main Street

"You get down to a philosophical issue of government competing against private industry," said Eric Breisach, an attorney with Fleischman and Walsh, the firm representing Mediacom. The lawsuit is not about the right of a municipal utility to build a system, but what financial resources it uses to build it, he said.

"Our attorneys tell us that we have followed the law," countered Curtis Dean, SMU spokesman.

"Mediacom want the courts to accomplish something they couldn't accomplish in the market."

To rally community support, SMU passed out yellow ribbons for backers to display. It plans to reward sympathetic residents with a free "sneak preview" trial of its cable



offerings in areas where its system is operational. As might be expected, more yellow ribbons seem to be flying in those neighborhoods.

Cable television and high-speed Internet access are the first services to be offered. SMU Communications received regulatory approval in August to provide local and long-distance telephone service to homes and businesses.

Mr. Dean said the system has strong popular support. In a 1997 referendum, 90% of the voters approved building the network and 60% signed on as charter subscribers.

But that was before Mediacom, one of the country's largest cable system operators, stepped in and made a significant investment to upgrade the town's ailing network, adding digital cable and lowering rates.

Backers contend the fight in Spencer is just the latest backlash from companies fearful of competition.

"I don't view what is happening there as anything more than what we have seen historically when investor-owned companies try to discourage municipal utilities from getting into telecommunications," said Bob Haug, executive director of the Iowa Association of Municipal Utilities.

WHO PAYS FOR FAILURE

Mediacom and other opponents cite Spencer as an especially egregious example of cross-subsidization. Of all the other public utilities building or considering telecommunications systems in the state, none is so open in having the existing utilities bear the risk.

"The heart of the lawsuit comes down to the manner in which it is financed," Mr. Breisach said. "Every penny that is going into construction and operating the system is coming from the electric utility."

The system is being built with two \$8 million debt facilities. One debt facility represents an "interfund" loan from the electric utility, which has built up a significant surplus, to SMU Communications. The other \$8 million is a revenue bond backed entirely by the electric utility.

Mr. Breisach said interest on the interfund borrowing is 4.5% and there are no set payment terms. The revenue bonds run at 5.75%. Both rates are significantly lower than a communications company might expect to pay on its own.

"The people who are all at risk are the captive ratepayers," Mr. Breisach said. "The revenue bond holders have a lien on all the revenues and assets of the electric com-



Spencer's Television Tower
Source: Spencer Municipal Utilities

pany." That is illegal under a new Iowa law designed to prevent cross-subsidization, Media-com contends.

SMU counters that the cable and fiber optic infrastructure belong to the electric utility, not SMU Communications. The utility was going to build a new communications system for itself anyway, and it is not unreasonable for a system's owner to pay for it. Also, the electric utility has a surplus more than adequate to cover losses.

Mr. Breisach said no other public utilities are following Spencer's model. "It is like a loan to your brother-in-law. They have testified they need 50% of the customer base. If they don't get it

who pays the bill?"

ECONOMIC DEVELOPMENT

Rural Iowa is home to many specialty agricultural companies serving international customers. They need high-speed Internet connectivity to stay competitive, and in many places they aren't getting it.

"Unless you are on a main route, you are not going to grow. These towns have a lot of pride and history," Mr. Haug said. And they are tired of poor service offered by local cable providers.



**Bob Haug, Iowa Association
of Municipal Utilities**

"It is starting to open some doors in economic development," Mr. Dean said. "It is very much like the advent of municipal electrics in the turn of the last century. Communities needed electricity to thrive and survive. Private industry couldn't get down to every town."

Spencer has had to overcome its share of bad luck over the years. After a child dropped a burning sparkler into a box of fireworks in July 1931, most of the town's business district burned down. But a strong civic spirit helped rebuild the community, which serves as a commercial hub for northwest Iowa.

Like many small towns in the Midwest, Spencer struggles with an aging and a declining population. Attracting cutting-edge employers is difficult without a modern telecommunications infrastructure.



SMU Communications is building a hybrid fiber-coax communications network with about 21 miles of fiber optics and 330 miles of coaxial cable. Construction, which started in July, is expected to finish early next year.

The cable package includes 59 channels of basic cable and 21 digital channels, 40 music channels and access to 27 pay-per-view channels. Basic digital service will run \$29.75 a month. SMU has also started assembling a 385-foot tower to receive television signals.

Besides cable, SMU Telephone will offer local and long-distance service, custom calling features such as caller ID, telemarketer call screening, and voice mail. Mr. Dean said the local telephone provider Qwest Communications International has not objected to its plans.

"There is an element of risk when a municipal utility gets into that," Mr. Haug said. "The risk is that they won't have advanced telecommunications services, they won't have choices in provider and they won't have reduction in rates."

Mr. Dean said the city and its residents were tired of being on the outside looking in at the telecommunications revolution.

COMMUNICATIONS CO-OP

In a move that could anger cable companies even more, communities like Spencer may seek to recoup their capital costs by serving neighboring towns that lack the resources to build their own systems.

"We have been in talks with other communities about sharing assets," Mr. Dean said. "We can help other communities improve their telecommunications." Spencer has a cable head-end to convert signals and a television antenna to receive local broadcasts.

Roughly 51 communities are at some stage of developing a public telecommunications system in Iowa. Although many municipal utilities lack the resources to do so, they are turning to elections to force carriers to improve service.

"Unless there is a credible threat to establish a municipal utility, communities don't have any leverage at all to get services they needed," Mr. Haug said.

Mediacom acquired Spencer's aging cable system in November 1999. The company upgraded it, launched digital services and lowered prices. Mr. Dean said rates in nearby communities without their own systems have risen 20%.



"They picked the wrong target," Mr. Haug said. "I am confident when the dust settles, the Spencer citizens will have their will."

