



Blue Ribbon Report on Burlington Telecom to City Council  
Public Document  
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Final

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## Overview of Work Performed

On December 14, 2009 the Burlington City Council passed a resolution to create the Blue Ribbon Committee on Burlington Telecom (BRC or Committee) and gave it the following charge:

- 1) Assessing the viability of BT in terms of:
  - A. Its current debt load
  - B. Additional financing necessary to comply with its CPG
  - C. Industry and technology trends.
  - D. Develop projections based on these trends and financing analysis of BT to determine its ability repay such financing and to preclude the necessity for relying on the full faith and credit or other resources of the City, and
- 2) Assessing all available options for the financial structure of BT including but not limited to:
  - A. The Piper Jaffray financing offer
  - B. Other possible financing options
  - C. Joint venture or equity sale
  - D. Outright sale of BT
  - E. Other options recommended by consultants

The committee convened its first meeting on December 21, 2009 and has met formally as a committee seven times. Those meetings were as follows:

December 21 – 3 hour meeting to review Council Charge and request information

December 29 – 5 hours to review BT business Plan

January 5 – 2 hour meeting to review consultants RFP, select RFP and define scope of work

January 12 -- 2 1/2 hour meeting to request further information from BT and staff, and to define end produce to be delivered to City Council.

January 19 - 2 1/2 hour meeting to discuss consultant's update and HBC overview

- January 26 - to review preliminary findings of consultants and draft recommendations
- January 28 - 8 hour session to review consultant reports and discuss BT with DPS
- February 1 - 2 1/2 meeting to formally review draft report
- February 4 - 2 hour meeting to further review of draft report; final document approved

The committee initially hired two consulting firms to assess the viability of Burlington Telecom. One of the firms was unable to commit to delivering an acceptable valuation so the committee decided to hire a 3<sup>rd</sup> firm just to produce a valuation. The scope of work that they performed is outlined in the Statement of Work in Appendix A . Actual consultant reports are in Appendix B.

The firms are as follows:

**Hiawatha Broadband Communications Inc. – A Telecom company in Winona, MN**

Labeled one of the nation’s best telecommunications companies by both the venerable Benton Foundation and Broadband Properties magazine, Hiawatha Broadband Communications, Inc. (HBC) on August 12, 2009 capped a summer of distinction by providing advice to the Federal Communications Commission (FCC) on the construction of a national broadband policy.

HBC was among a handful of companies – and the smallest selected – to provide advice to the Commission as it began research into the elements that should be included in the national policy the FCC is charged with developing before the end of 2009.

Hiawatha was chosen to consult BT and the committee based on the fact it is a similar size telecom company that could provide meaningful benchmarking data in analyzing BT’s viability. In addition HBC was familiar with BT and could meet our tight deadlines to provide us valuable feedback and guidance.

**Stratum Broadband – Medway, MA**

Stratum Broadband is a planning and technology consulting company that specializes in developing integrated strategies for deploying broadband networks. Stratum’s primary clients are schools, hospitals, and municipal governments. Stratum is composed of personnel with extensive experience deploying and managing both wired and wireless commercial networks for companies such as AT&T, and other large carriers. Stratum personnel have the unique perspective to see what was, understand what will be, and the find the best solutions for their clients network arrangements.

**North Point Consulting Group – West Lebanon, NH**

NorthPoint Consulting Group is a research and consulting firm with expertise in economics, finance, econometrics, statistics and public policy analysis. Current and recent clients include public utilities, regulatory commissions, industrial groups, law firms and government agencies.

The firm has the expertise to analyze evidence and clarify issues in the regulatory and public policy arena. NorthPoint Consulting Group conducts long-term basic research projects and provides advice and expert witness testimony for industries that include electric, gas, water, telephone and cable television.

The committee's findings and recommendations have been based on the information gathered during these public meetings, the work performed by the consultants, and the review of the following documents:

- 1) BT's November 2010 internal financial statements
- 2) BT's unaudited June 30, 2009 financial statements
- 3) BT's 2009 Business Plan, and 5 year Pro-forma
- 4) BT's responses to discovery request from Vermont's Department of Public Service
- 5) Piper Jaffray financing proposal
- 6) RFP's from investment bankers
- 7) Internal BT documents on pricing, sales analysis, and business activities

## Executive Summary

The following report specifically responds to each of the questions raised by the City Council. The overall assessment of BT from the Blue Ribbon Committee is as follows:

- BT fiber network is a significant asset to the City of Burlington, its businesses and residents.
- BT overpaid for this investment and the debt load is too great to be covered by the revenue and earnings from Burlington Telecom. Without successfully negotiating significant reductions in debt with its creditors, at least \$15 to \$20 million of this investment might never be recaptured.
- Simply borrowing more debt to meet its current obligations will only prolong the reality that the City must right-size BT. The BRC does not support borrowing more money to do so.
- If BT can be successful in right-sizing, the overall strategic plan of Burlington Telecom must shift from engineering and technology based to one based on sales, marketing, and customer service in order to be successful in the future. Organizational structure should be refined to meet the needs of such a strategic plan.
- The Committee recommends that the City consider developing a restructuring strategy that would achieve 3 basic objectives

- 1) Continue to allow the residents and business of Burlington to benefit from the fiber investment made to date by Burlington Telecom
- 2) Allow BT to continue to operate under new governance and ownership with the experience of marketing and selling telecom services.
- 3) Provide a long-term opportunity for the City of Burlington to realize a return on its investment in Burlington Telecom.

Key in the committee's deliberations was a review of several policy issues relating to Burlington Telecom. Any implementation plan should take BT's CPG and other relevant legal issues into account. To arrive at viable solutions, assumptions had to be made about BT's ability to renegotiate its CPG. The timeline of the renegotiations may impact the implementation timeframe of the committee's recommendations. The committee discussed and acknowledged the recent lack of transparency as an impediment to a successful overall business strategy, particularly in the commercial market. The issue of rapid technological change and the presence of global powerhouse competitors in our immediate market are challenges in both their access to capital and human resources that is far greater than that of Burlington Telecom. No matter what form BT takes in the future, it must be able to hire and retain qualified private sector, entrepreneurial staff with the skills necessary to take BT from a technology-centric management structure to a sales/marketing and customer service powerhouse of its own.

The Committee recognizes that some of our recommendations may run into regulatory road blocks and need modification. The Committee is willing to reconvene in order to review alternative proposals as various opportunities and constraints arise.

## Responses to City Council's Charge

### Assessing BT's viability as it relates to:

- A. **Its current debt load** The committee was faced with the question of viability of Burlington Telecom. There have been many discussions of the meaning of viability and how it might relate to BT. We should first report our working definition:

**vi·a·ble** [ vɪ əb'l ]

adjective

#### **Definition:**

1. **practicable or worthwhile:** able to be done or worth doing
  - *a viable proposition*

Based on this definition and the challenge before the Committee, we have settled on answering the basic question of “is Burlington Telecom able to support the current debt structure based on the current financial situation of BT and the forecasted situation in the 2009 Business Plan?”

- The Committee has determined that BT is not viable in relationship to its current debt load of \$51 million and its ability to generate earnings to pay off this debt. BT cannot meet its principal and interest obligations at this time and the Committee does not feel the current business plan can generate the “EBITDA” earnings before interest, taxes, depreciation and amortization, to meet its debt obligations in the future.
- Refinancing the \$51 million of current debt at an interest rate between 4% and 5%, would require an annual debt service of at least \$3 million. The committee is not comfortable BT can support this today or in the near future. In order for BT’s EBITDA to cover a debt service level in excess of \$3 million, we estimate revenues would need to exceed \$25 million compared to current revenue of \$7 million. This is based on an industry average of 19% EBITDA to revenue ratio and BT is currently operating at 14.6%.
- BT’s business plan does support covering this debt service level by 2014; however, it assumes a EBITDA to revenue ratio of 40% (in low case business plan), that we have determined is not realistic.
- The consultants came to the same conclusion.

**HBC Report** – “Given the current state and performance of the Burlington Telecom business and the baseline financial projections for the next five years, Burlington Telecom is not able to sustain any debt load level until month 31 of the five-year financial model projections.” (see page 12 of HBC report)

“During the first 30 months, Burlington Telecom would need to borrow an additional \$13,250,323 in order to grow the business, complete its statutory build-out requirements for the City of Burlington, update its hardware and software technology platforms, meet its maintenance capital needs, and sustain its operating cash flow losses.” (page 12 of HBC report)

**Stratum Report** – “Stratum does not believe that the current business plan, with its current assumptions, is viable or will reach cash flow break-even within a reasonable timeframe. In these circumstances, BT’s existing debt exceeds its ability to service it. We therefore do not recommend a maximum 5 year debt capacity for BT under these circumstances. “ (see page 8 of Stratum report)

Stratum simulated numerous sensitivity analyses assuming a significant effort to gain more customers, in scenario’s where BT would increase or decrease price. In none of the situations could Stratum identify a vehicle to cover debt service above \$3 million. The proposed debt service of \$4.5 million cannot be covered by BT’s growth even in the best case scenario. (see page 7 of Stratum report)

Borrowing additional dollars to fuel the operation and any further expansion in Burlington of BT is not practicable without exposing the City’s taxpayers to a greater risk and potentially further risking the City’s credit rating. It is our conclusion that BT should not solve this problem by further borrowing debt

at this time. The current debt levels are not supported by the current operations nor the estimated operations in the 2009 Business Plan. Although the organization reaches a point of positive cash flow under the plan in 2014, it is primarily a result of a debt structure where interest and principal payments have been postponed until 2014.

**B. Assessing BT's viability as it relates to additional financing as required to comply with the CPG**

In order to comply with the CPG, BT would have to pay back all outstanding amounts owed to the "pooled cash fund." This would require new financing of roughly \$17 million. BT would also be required to complete the passing of 3,000 remaining homes in areas that are either hard to reach geographically or hard to reach due to private roads and rights-of-way. We have estimated another \$12 million to \$15 million would be needed to comply with the BT's obligation under Condition 17 of the CPG. Therefore in order to re-finance the Citi debt \$33.5 million, pay back the City's pooled cash of \$17 million and secure new financing for expansion and funding capital, BT would be looking at a new debt load of \$62.5 to \$65 million. As indicated above, we have concluded that BT is not viable with \$51 million in debt. We also conclude the same would be even more true at even higher debt levels.

**C Assessing BT's viability as it relates to future technology and industry trends:**

A significant market strength that BT enjoys is its passive optical fiber to the home (FTTH) network. Not all FTTH networks are created alike, yet the HBC consultant's report identified BT's network as "first class" (see page 4 of HBC report).

BT's landline competitors are providing broadband with coaxial cable (coax) and copper cables. A comparison of fiber optic networks versus coax or copper cables clearly favors fiber:

**Fiber**

The laws of physics are on the side of fiber. Fiber has unlimited bandwidth as its capacity is defined by the number of colors in the rainbow – which is infinite.

**Coax**

Coax is a shared facility and as such has finite capacity restrictions.

**Copper**

Copper, utilized to provide digital subscriber lines (DSL) service, is a dedicated facility that is limited by the industry's ability to compress signals.

It should be noted that major carriers are adding fiber to their coax and copper networks to enhance capacity and performance. Additionally, fiber networks require less maintenance than coax or copper due to their age and passive network components. Fiber will also face competition from wireless technologies – cellular and satellite.

### **Cellular**

The cellular network continues to evolve at an exponential pace. The current constraint with wireless is the limited amount of cellular spectrum available for use in the USA. This will be addressed by the FCC, but not in the short term. A comparison of current and future bandwidth capacity between fiber and cellular networks would favor fiber.

### **Satellite**

Satellite services have significant performance issues associated with latency. The latency is insurmountable due to the physics associated with the distance between the earth and the satellite. It must be recognized that landlines and cellular networks address different market needs. There are reasons why Verizon and AT&T have both FTTH/FTTC (Fiber to the Home/Curb) and cellular networks.

In summary, BT has the best technology available today for local broadband networks and it is the most adaptable to unknown future service requirements.

### **Future Improvements**

Although BT's network is "first class", all technology requires upgrades on an ongoing basis. The HBC report indicated that there were significant technology upgrades that will need to occur to BT's network long-term. The estimated cost of these upgrades was \$15 million over the next 5 years, plus an additional \$1.2 million per year on an ongoing basis.

## **2A. Assess all funding options for the financial structure of BT including the Piper Jaffray financing offer**

On November 13, 2009, the Administration announced that a refinancing proposal for Burlington Telecom had been secured from Piper Jaffray & Co. (Piper) in the form of a Letter of Intent (LOI) along with a proposed Term Sheet. The LOI proposed:

- "Piper would act as manager and Underwriter of an issue of \$60,650,000 of Certificates of Participation (COPs) for the purpose of re-financing BT's \$33.5 million lease purchase agreement with Citi Capital and financing BT's outstanding \$16.9 million (approximate) debt to the City's pooled cash in the form of an Interfund Transfer. The remaining money would be a debt service reserve fund."

Following the LOI, there were many questions surrounding this proposed issue, not the least of which were questions stemming from a conversation with Piper where they acknowledged that Piper had not done any due diligence on BT's ability to support the debt service on the issue. In their mind, they were basing their LOI on the City's "good name" and reputation for repayment.

The City Council, on December 14, 2009 voted not to execute the LOI allowing the Administration to negotiate with Piper on the issue.

On January 21, 2010, Piper submitted a response to the RFP for underwriting proposals. Essentially, their proposal was unchanged from its original recommendation of the issuance of \$60.6 million of COPs.

Through the RFP process, 6 proposals were received. The top 3 were selected and reviewed by Staff and the BRC. Conference calls took place with each of the top 3 respondents. Through those calls and follow-up discussions among the BRC, a few key points were unearthed:

- The RFP responses were not commitments to lend a particular amount at a given rate. It is our assessment that the City would be responsible for the due diligence to determine the maximum debt load that could be supported by BT without risking taxpayer funds or the credit of the city.
- Issuance of Certificates of Participation relying on the revenues of BT alone would likely not be investment grade. This would lead to a significantly higher interest rate and a lower likelihood that the respondent would be able to issue and sell the debt. In the event that BT revenues were insufficient, if non-tax revenues of the City could be used, that would make the issue more marketable.
- The debt service required for the amount of lending suggested, even at the low interest rates proposed by the lenders, would be in the ballpark of \$4.2 million annually for 20-30 years.
- Although the expected lifetime of fiber is longer than 30 years, the electronic assets of BT would be replaced numerous times during that period.
- Although fiber is the networking mode of choice today, we cannot say with confidence that this will still be the case in 30 years.
- The BRC is not comfortable that the pro formas presented by either BT or HBC are sufficiently realistic to be confident that BT could support the necessary debt service while also funding ongoing operations and capital improvements. Stratum concurred with this conclusion.

**D. Recommendation on Outright Sale of Burlington Telecom**

The Committee does not recommend the outright sale of Burlington Telecom to a third party. Both consultants, HBC and Stratum, advised that the sale of Burlington Telecom was not in the best interest of the community or the taxpayers.

HBC states on page 11 of its report: “The City has a considerable asset in BT and should not give this asset away at a fire sale price. BT is too important to be jettisoned. It is important to the City’s economic development by way of new business attraction, it is important to keeping current businesses competitive in the marketplace, it is important for offering educational opportunities over such a network, and it is important to keeping the incumbent providers “honest.”

HBC reiterates this position in its Viability Analysis stating: “As mentioned earlier and often, Burlington Telecom represents an asset that, in our opinion, the City of Burlington should neither relinquish nor spin off.”

Stratum Broadband states in their analysis: “BT failure or sale results in the city absorbing \$15-30M loss – probably unacceptable without making an effort to turn it around.” (See page 16 of Stratum report) It then concludes in the final statement of the report, “Stratum believes that if [our recommended] strategy is effectively implemented, BT can sufficiently increase both its residential and commercial

subscriber base to reach break-even cash flow, including debt service and capital requirements. At break-even, with a significantly larger subscriber base, BT will have the flexibility and greater leverage to drive total Burlington-based revenues, evaluate additional services and geographical expansion options.”

Furthermore, the information that the Committee received on the valuation of Burlington Telecom leads us to believe that an outright sale of BT in its current situation would not result in repaying any of the pooled cash, and also would not be likely to cover the existing debt to CitiCapital. Other courses of action recommended by the Committee offer more benefits to the citizens of Burlington and solutions to recover the taxpayer funds already invested in the BT. There simply would be no benefit to selling BT outright because both the community asset and the City funds would be lost.

While the Committee does not believe an outright sale of BT would provide any benefit to the citizens and taxpayers of Burlington, as discussed elsewhere in this report, we do think that a partial sale and/or partnership can provide a realistic opportunity to move BT forward and protect the community’s investment.

#### **E. Alternative Organizational Structure**

Both consultants who performed a full evaluation of BT highlighted an extremely important point: BT’s fiber network is a valuable community development asset to the City, and a loss of that asset would be detrimental to the City’s future. The BRC unanimously concurs with this view. The asset is valuable to the city in many ways:

- Economic Development
  - Attracting new businesses to the City
  - Retaining existing businesses in the City
  - Competition drives down pricing of all providers, creating more free cash for consumers to purchase goods and services in the City
- Becoming Green
  - The network provides the infrastructure for smart metering, which could lead to long-term reductions in the City’s power consumption
  - The limitless bandwidth of fiber enables telecommuting and ensures the ability for telecommuters to do so for many years into the future. This reduces carbon emissions and also brings more high-paid jobs to Burlington which otherwise may remain in other cities and states.
  - High-end video conferencing is enabled by the bandwidth of fiber that minimizes the need for travel.
- Future-Proofing
  - Burlington has historically been left behind for years after a new communications technology is created. Although competing residential services are now on par with BT’s current offering, without a fiber network like BT’s, Burlington will again be left behind when future technologies like 3D TV are released.
  - The landscape of commercial telecom services available in Burlington continues to pale in comparison to the type of infrastructure and value that BT can provide to a business.

The committee conceived a variety of strategies and approaches. We recognize the need for flexibility as the financial and legal implications of different approaches need to be considered. We also recognize the time sensitive need to address the issues related to non-compliance with Condition 60 and the City's credit rating. In light of the fact that the fiber network is an extremely valuable community development asset to the City, the following steps should be undertaken to enable BT to become a viable telecommunication network:

- The first step is to retain an expert financial advisor to consider short and long-term strategies towards implementing the recommendations listed below
- Restructure BT's debt to relieve the current debt burden
- Seek equity investment by entering into a partnership with a private entity or otherwise obtaining private investment
- Create a new entity, "BT Inc." to manage and operate the business of providing telecommunication services, with a board of directors that includes minority representation by the City
- Make staffing and operating model changes consistent with the reports and recommendations of the consultants' to the Blue Ribbon Committee

In conclusion, BT is a valuable asset – a "platform for innovation" according to Stratum's presentation – to the City. It cannot be viable under its current configuration. It can however be viable with a financial restructuring that secures favorable terms and conditions, creation of BT, Inc. as a for-profit corporation, and identifying a majority investor to provide needed capital for technological upgrades, operations, and future growth of the business. It must also refocus its entire structure to one of a company emerging out of distribution and into customer retention, expansion and all the attributes that a viable business in the private sector embraces successfully.

There is a significant opportunity for a strategic partner investing in BT's business. BT has thousands of existing customers; thousands of potential customers along the existing fiber pass; and an existing core infrastructure with a hub capable of serving 100,000 customers that could enable significant future expansion and economies of scale.

There is a confidential portion to this report. It is confidential because it contains a strategic plan for BT to restructure and enter a new phase of its evolution; one that can be commercially viable and benefit the City of Burlington.