Minutes of the Centerville City Council **work session** held Tuesday, September 9, 2014 at 6:00 p.m. at the City Hall Training Room, 250 North Main Street, Centerville, Utah.

MEMBERS PRESENT	
Mayor	Paul A. Cutler
Council Members	Ken S. Averett Tamilyn Fillmore John T. Higginson Stephanie Ivie Lawrence Wright
STAFF PRESENT	Steve Thacker, City Manager Lisa Romney, City Attorney Katie Rust, Recording Secretary
STAFF ABSENT	Blaine Lutz, Finance Director/Assistant City Manager
CITIZEN ADVISORY COMMITTEE	Mark Austin Randy Burgoyne Ann Fadel John Urry
VISITORS	Wesley McDougal, FirstDigital President Alex Jackson, FirstDigital Director of Operations

FIRSTDIGITAL PROPOSAL

Mayor Cutler introduced Wesley McDougal, President of FirstDigital, and Alex Jackson, FirstDigital Director of Operations. FirstDigital, headquartered in Salt Lake City, is a provider of telecommunications services. Since 2000, FirstDigital has constructed and managed fiber-based networks for companies in the wholesale, commercial, institutional and residential markets. Mr. McDougal explained the current financial state of UTOPIA as he understands it: $220 million in existing bond debt, $8 million in annual revenue, and ongoing operating losses of approximately $3 million per year. Of the $220 million, $110 million has gone toward putting fiber in the ground, $70 million has gone toward interest, and $36 million has covered operational shortfalls. A significant amount has been invested without significant revenue. Mr. McDougal also mentioned the current imbalance between the eleven UTOPIA cities with some cities, like Centerville, having been built out while other cities have not. Mr. McDougal stated that UTOPIA currently has $2 million in cash reserves to continue build out. Voting power on the UTOPIA Board is determined by pledge amount, with West Valley, Layton, and Midvale holding 50.7% of the voting power. FirstDigital has presented its proposal to the UTOPIA Board, and eight of the eleven cities voted in favor of pursuing the FirstDigital proposal. The controlling three cities voted to not pursue the FirstDigital proposal at this time. FirstDigital intends to present its proposal individually to each city council.

Mr. McDougal presented four possible solutions for UTOPIA moving forward:

- Draw down more bond obligation to build out, understanding that bond funds can no longer fund operations.
- Mr. McDougal explained that allowing the network to go "dark" is not really an option, but the network is valuable and could be sold. FirstDigital made an all-cash offer (greater than $42 million) to purchase the network in May 2014, which was rejected by the UTOPIA Board.

- Adopt a utility fee model. Six of the eleven cities have voted to continue considering the Macquarie utility fee proposal, and five cities, including Centerville, have rejected the utility fee model.
- Adopt a non-utility fee, demand driven build out of the network as proposed by FirstDigital.

Mr. McDougal explained that the FirstDigital proposal does not require a utility fee. FirstDigital would expect to invest more than $100 million of private capital. Mr. McDougal stated that with a partnership between FirstDigital and UTOPIA/UIA, both entities could put capital toward build out. If UTOPIA chooses not to invest more capital, the FirstDigital solution would not require any additional public debt. Mr. McDougal said that with the existing FirstDigital management team, technical team, engineering team, and customer service team, synergy would exist between FirstDigital and UTOPIA/UIA to reduce operating expenses and eliminate operating losses. Mr. McDougal stated FirstDigital is confident enough to indemnify the cities against further operating losses.

Mr. McDougal continued that the proposed partnership between FirstDigital and UTOPIA would allow an open-access wholesale network with a choice of providers and applications. Build out would continue. He stated that cities would participate in the expected cash flow to help in paying off debt obligations. FirstDigital would focus sales and marketing on a local level, rebranding the network with city-specific plans. Mr. McDougal explained that FirstDigital has fiber from St. George to Brigham City, with a residential focus on multiple-dwelling unit (MDU) new builds. Financially FirstDigital is more than three times the size of UTOPIA. Mr. McDougal expressed a desire for the public to know that there is an alternative to a utility fee model, and said he feels the FirstDigital proposal is a good fit for Centerville.

Councilman Higginson asked Mr. McDougal why he feels West Valley, Layton, and Midvale did not want to move forward with the FirstDigital proposal. Mr. McDougal responded that the cities are out of parity or balance. West Valley has $5 million of network assets and $45 million in debt obligation. FirstDigital wants the cities to have a choice moving forward. Councilman Higginson asked if FirstDigital would be interested in moving forward with only Centerville, if Centerville were allowed to act independent of the other cities. Mr. McDougal responded that FirstDigital would absolutely want to move forward with Centerville. Although it would be complicated, he said there is no technical reason it would not be successful. Ann Fadel, a member of the Citizen Advisory Committee, asked why UTOPIA did not want to sell to FirstDigital in May. Mr. McDougal said it is complicated for the UTOPIA Board - with $220 million of existing bond debt, the bond holders expect a secured asset in the network.

Ms. Fadel asked if FirstDigital would require an installation/connection fee similar to the $2,700 required now. Mr. McDougal responded that installation would be similar to the market rate of $50-$60. When asked about the citizens who already signed up and paid the $2,700 connection fee, Mr. McDougal responded FirstDigital would want to find a fair solution.

Mayor Cutler asked Mr. McDougal to outline the thresholds under the proposal for a neighborhood build out. Mr. McDougal explained that if the network is in place in a neighborhood there would not be a demand requirement. For each new neighborhood, FirstDigital would look at the cost to build to the neighborhood, and apply a take-rate requirement to meet the costs of building to that neighborhood. Build out would be incrementally more cost effective as the network is built out. Councilman Higginson commented that UTOPIA and the cities have been limited in their ability to promote and market the network as a product. He asked Mr. McDougal if FirstDigital has anticipated what their efforts would be. Mr. McDougal responded that instead of relying on a third party for marketing, FirstDigital would focus the marketing within each city and expect demand to increase. Councilman Wright asked

if the city councils would be involved in the branding for the cities. Mr. McDougal responded that FirstDigital would want to be congruent with what the cities want. Lisa Romney, City Attorney, pointed out that under the Utah Telecommunications Act, the City cannot market to the end user. She said in her opinion, if the cities are specifically advertising the wholesale network, not the services provided, they are clear of advertising to the end user. FirstDigital does not currently sell retail services in the residential market.

Councilman Wright asked how ownership of the network would evolve with FirstDigital's involvement, and asked for Mr. McDougal's definition of an open network. The cities do not own the network except through shares and a voice on the Board. Councilman Wright said he believes the argument about parity and equity is against the UTOPIA Interlocal Agreement. Mr. McDougal responded that currently UTOPIA owns the network. FirstDigital can build to the UTOPIA network and connect customers for a fee. In the proposed partnership, the existing network would be owned by UTOPIA/UIA, and new build out would be owned by whatever entity pays for the build out. A fee would be paid to UTOPIA for use of the UTOPIA network. The result would be incremental revenue without incremental costs. He said with the proposed partnership there would be flexibility for ownership to change in the future. Councilwoman Fillmore asked how the cash flow and profit sharing would work. Mr. McDougal responded that cash would go to UTOPIA/UIA for distribution to the cities. The cities could participate in continued build out at whatever level desired.

Mr. McDougal explained FirstDigital has identified three categories of existing conditions: existing network; infill areas where the network passes but does not connect to customers; and edge-out areas, which require more capital. FirstDigital anticipates that with their capital, along side the remaining UTOPIA capital allocated for build out, they should be able to completely build out the existing and infill areas. Councilwoman Fillmore pointed out that the utility fee model would be a more pure revenue sharing scenario. Mr. McDougal said that in a demand-driven build out the existing and infill areas have the competitive advantage. UTOPIA would receive fifty percent of the revenue generated from use of the network, less operating costs.

Mark Austin, a member of the Citizen Advisory Committee, asked Mr. McDougal to clarify what information regarding the proposal is public and what is not public. Mr. McDougal responded that information provided on the summary handout, and anything discussed in the work session, is public information.

Mr. McDougal explained that FirstDigital is a wholesale provider of the fiber, but would make sure that the end users are aware of the providers and applications available through marketing. FirstDigital would provide marketplace information regarding services and applications available and associated costs. Mayor Cutler stated he feels the FirstDigital proposal is the best proposal for Centerville, and asked if, under the proposed situation, he would continue to receive a bill from his service provider. Mr. McDougal responded the Mayor would receive a bill from FirstDigital, and would only receive a bill from a provider if he selected additional services. FirstDigital would then pay the providers after subtracting an amount to fund functions critical to the success of the network (i.e., advertising), eliminating a current marketing disconnect between UTOPIA and ISPs. Providers like Netflix would continue to bill the end user directly. Mayor Cutler pointed out that this proposal would be a drastic change from the current situation. The Council discussed the fact that each UTOPIA city has different needs. Under the proposed partnership with FirstDigital, FirstDigital would act as operational partner with control over which strategies to use in the different cities, rather than the UTOPIA Board trying to agree on one strategy for all.

Councilwoman Fillmore asked if the providers would consider the proposed partnership to be an open access network. Mr. McDougal responded that yes, more providers would be able to participate on the network with the FirstDigital proposal. Mr. Jackson referred to Netflix as an example, pointing out that if customers had a problem with the internet connection, they would contact FirstDigital. If customers had a problem with the Netflix service, they would contact Netflix. Providers would not be limited regarding marketing, and would have more visibility in the marketplace with FirstDigital. Mr. McDougal stated that FirstDigital has spoken with many providers that would be excited to have unfettered access to the network. He added that providers would have to meet minimum requirements to guarantee a quality product. The end users would have choice and flexibility in selecting providers.

Steve Thacker, City Manager, asked Mr. McDougal to explain the three-year opt-out provision included in the FirstDigital proposal, as well as the utility fee option in the proposal. Mr. McDougal explained that with the utility fee option included in the FirstDigital proposal, the cities would receive more revenue than they would with the Macquarie utility fee proposal. FirstDigital would put in the equity and obtain the debt. Under the FirstDigital utility fee model, if after three years one of the partners decided to pull out of the partnership, the debt in place would be assumed by the cities, and FirstDigital would be reimbursed for its invested capital. Councilman Wright asked what would lead FirstDigital to opt-out after three years and what would be in place to protect the cities. Mr. McDougal responded that the protections have not been completely flushed-out, but FirstDigital would want to ensure that the situation is fair. The cities would retain ownership of the network. The proposal includes a 30-year irrevocable right-of-use to prevent network assets from becoming stranded in the event that either partner opts out. A transport fee would continue to be paid to the existing network.

Councilman Wright stated one thing he liked about the Macquarie proposal is the use of metrics. He asked what type of metrics FirstDigital would provide to UTOPIA/UIA and the cities. Mr. McDougal responded FirstDigital would have a customer bill of rights with metrics for service to the customer. There would also be stringent metrics regarding operation of the network. He said if FirstDigital were not able to operate at the established standards the cities would have the ability to select a new operator. Mr. McDougal added that FirstDigital would be significantly invested, and their measuring stick would be customer retention.

Councilwoman Fillmore referred to the fact that the current UTOPIA customers are subsidized by the cities. She said she believes the cities want to accomplish the original goal of operating successfully, and asked Mr. McDougal for examples of how the cities could be involved in the plans to participate in the cash flow. Mr. McDougal responded that Centerville is almost completely built out and very little capital will be needed. He said he sees a need to start marketing locally and to participate in local activities, and expressed confidence that focused dollars will have a big impact. Councilwoman Fillmore expressed a concern that with the FirstDigital proposal it would get muddy and complicated as to who paid for what. She would not want to see FirstDigital use the basic infrastructure without paying and enjoy the revenue from what the cities have carried for years. Mr. McDougal stated that FirstDigital and other companies are already building to the UTOPIA network and paying transport fees. The advantage to moving forward with the FirstDigital proposal would be having a partnership with a company that wants to utilize the UTOPIA network and pay the fee, which will drive more and more business to the network. Councilwoman Fillmore asked if it would be possible in the future to invite other cities to join in the network. Mr. McDougal responded that he knows there are other cities that are interested in having their own network. He said he does not know if other cities would want to connect to the UTOPIA network and pay the transport fees.

Councilman Wright asked if the transport fee revenue would go directly to the cities or to UTOPIA. Mr. McDougal responded the money would go to UTOPIA/UIA, and the Board would distribute the revenue. Councilman Wright asked what would happen to the existing UTOPIA corporate structure. Mr. McDougal stated he suspects UTOPIA personnel would be integrated into FirstDigital. The UTOPIA employees have valuable knowledge of the network. John Urry, a member of the Citizen Advisory Committee, stated that Macquarie has indicated the network is in great need of refresh and asked Mr. McDougal for his opinion. Mr. McDougal responded that FirstDigital has requested equipment lists from the UTOPIA Board but not received that information. He said he thinks some upgrades will be necessary, but there is a lot of life currently in the equipment. Upgrades would be considered capital expenses covered by the partnership or FirstDigital. Mr. McDougal said he anticipates most upgrades would be associated with expansion and new builds. Mayor Cutler stated that Macquarie's intention as he understands it would be to put in completely new equipment for uniformity throughout the cities. Mr. McDougal said FirstDigital would not require all new equipment.

Councilman Wright asked if the cities would be required to fund future upgrades to stay current with the rest of the industry. Mr. McDougal responded they expect the network to continue to grow and would not expect the cities to put in capital for the growth. There would be cash from the partnership to fund that type of growth. Mayor Cutler added that the cost of equipment is going down, not up. Mr. McDougal stated that the real expense of the network is digging up ground and putting fiber under the streets.

Mayor Cutler stated that, from Centerville's perspective, the FirstDigital proposal looks great, but from the viewpoint of some of the other cities, the high threshold will prevent build out to new neighborhoods. The Mayor asked what would happen if the thresholds are not met to build out to new neighborhoods. Mr. McDougal responded that the areas that require substantial investment are the ones that are furthest away from existing network. FirstDigital would focus first on the close areas, and, fundamentally, if minimum requirements are not met in new neighborhoods there is not much they can do. It would be FirstDigital's job to teach the end users that fiber to the home is the best option. UTOPIA has been building where demand exists, and Mr. McDougal said that would continue, but the more built out the network becomes the easier it will be to convince customers.

Referring to the utility fee approach in the FirstDigital proposal, Mr. Thacker stated he assumes that using the utility fee approach within a footprint area of a city would require the creation of a special assessment area within the footprint, with a majority of residents within the footprint in support of the utility fee decision. Mr. McDougal stated FirstDigital would be flexible within the cities to meet the needs. Councilwoman Fillmore asked if the utility fee assumption would change based on how many cities participate in the utility fee model. Mr. McDougal responded that in most cities the proposed $20 would adequately cover the costs. FirstDigital has discussed the possibility with other cities of a lower utility fee that would fund a portion of the cost. The utility fee with the FirstDigital proposal would be city specific.

Councilman Higginson asked who would control the decision of where to build out in the proposed partnership between FirstDigital and UTOPIA. Mr. McDougal responded that FirstDigital would make that decision, which would remove politics from the picture and make build out a financial decision. FirstDigital has visited with four city councils with great response. They expect to visit all eleven cities before November. The Council discussed the complications involved with the UTOPIA Board making decisions moving forward. Mr. McDougal stated FirstDigital has put a lot of time and money into the proposal. Even if some of the cities go forward with Macquarie, other cities will still need a solution. Mayor Cutler stated it would be very difficult to break up UTOPIA. New entities can be created to do new things, but UTOPIA cannot break up until the debt is paid off. Mr. McDougal said that FirstDigital is excited that

eight cities wanted to explore the FirstDigital proposal further. FirstDigital is local and will be here for the long haul. He said he feels the option presented by FirstDigital should be included on any survey distributed by cities to gather public opinion.

Mayor Cutler stated that although UTOPIA is in a difficult situation, last month the network experienced the highest number of sign-ups in a long time. The asset in the ground is valuable, and the cities need to work together to find a solution. Mr. McDougal expressed appreciation for the Council's time, and encouraged them to contact him with any further questions.

ADJOURNMENT

Mayor Cutler adjourned the work session at 8:00 p.m.

Marsha L. Morrow, City Recorder

10-21-14
Date Approved

Katie Rust, Recording Secretary

CENTERVILLE CITY UT
CORPORATE SEAL

SPECIAL WORK SESSION

CENTERVILLE CITY COUNCIL MEETING

Tuesday, Sept 9, 2014

7:00 p.m.

NAME (PLEASE PRINT)	ADDRESS**
STEVE ALLEN	133 ROCK MANOR DR
NEIL LISH	428 E. 1200 N.
HOWARD SAIN	1020 N. MAIN
Jim Higbee	76 W Bradley Dr
John Urry	216 Canyon Breeze Dr
William Luce	1148 N 300 East Ctrville
Blaine Roskelley	93 N. 100 E Centerville
DOROTHY D. CALL	296 N. 300 E. CENTERVILLE
Ralph MITCHELL	262 PARK LANE grstscats@MSN.COM
Joan Willden	1378 N 15 W.
Randy Burgoyne	377 Willow Vale Cir.
Lea Skabelund	466 E. 2005. Centerville
Rick Bingham	290 E. Casa Loma Dr.

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