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UNDERSTANDING THE DEBATE OVER GOVERNMENT-OWNED BROADBAND NETWORKS:

Context, Lessons Learned, and a Way
Forward for Policy Makers

Groton Case Study

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Groton, Connecticut

The government-owned broadband network deployed in Groton offers another example of a failed GON. Built amidst much acclaim and anticipation in the mid-2000s, the network quickly collapsed under the weight of soaring debt and tepid consumer demand. In early 2013, the city sold the system to private investors for \$550,000, representing a loss of over \$30 million. The city and its taxpayers remain responsible for more than \$27 million in loans. This case study examines the motives that drove this GON's deployment and highlights the flawed assumptions that undergirded an unsuccessful financing plan and unrealistic business model.

Background

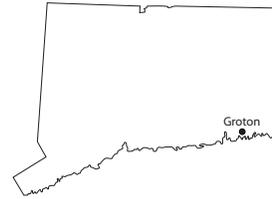
The communications network that would eventually grow into a GON grew out of a strategic plan that the local utility, Groton Utilities, floated in 1999. As a result of declining revenues in its core business, the utility outlined a plan for constructing a 32-mile fiber-optic network, access to which would be sold on a wholesale basis to ISPs.¹ According to a company official, the initial impetus for this endeavor was to “make money” in an effort to offset sagging electricity revenues (at the time, the utility was also “developing plans to begin producing bottled water”).² Later that year, residents approved a \$6.9 million bond issue to support construction of the network.³ The municipality prevailed in the legal challenges that followed,⁴ and by the early 2000s it began to develop plans for deploying a hybrid fiber/cable network that would extend cable service to residents and thus compete directly in the market for broadband and television.⁵

Those who advocated for a municipal network in Groton were driven, in part, by local dissatisfaction with incumbent ISPs.⁶ A survey commissioned by the state found that, of the 400 residents polled in the five towns that would be served by a municipal cable entity, 64 percent indicated they would be “very likely or likely” to switch cable services “if a new competitor entered the market.”⁷ In response, incumbent firms argued against municipal entry by noting the many risks to taxpayers associated with owning and maintaining such a vast communications infrastructure.⁸ The utility pressed ahead, and in 2003 the Groton City Council approved its plan. It authorized the formation of Thames Valley Communications (TVC), a city-owned taxable stock corporation, and approved a total of \$6.9 million for the development of this new enterprise.⁹ TVC was granted a franchise on January 1, 2004;¹⁰ network construction began soon after, and parts of the network went live in May 2004.¹¹ Construction would stretch over the next few years.

Cost and Financing

The Groton GON was a costly venture for the city, its taxpayers, and its bondholders. Initial startup and construction costs totaled \$16.9 million.¹² The city borrowed \$34.5 million between 2006 and 2008 to build and expand the network.¹³ This was substantially more—in terms of total dollars and total

Groton, Connecticut At-A-Glance



City Population: 40,115 (2010)

Year of Network Launch: 2004

Current Status: Built and Sold

Number of subscribers: NA

Revenues: NA

Operating Expenses: NA

Note: Additional information on the Groton network is contained in Table 1 and in Appendix I.

debt—than initially estimated by the city officials, who, in 2001, thought the entire network would cost “\$25 million to \$30 million, to be paid with operating revenue from the cable business.”¹⁴

The Network

The network TVC eventually built was capable of delivering telephone, Internet, and cable service to residents and businesses in Groton, Gales Ferry, Stonington, and Pawcatuck.¹⁵ From the beginning, some observers viewed the GON as financially unsustainable. It lost an average of \$2 million a year while owing nearly \$30 million in debt.¹⁶ By 2012, the city decided to sell off the network to private investors. CTP Investors bid for, and eventually won, the right to purchase the GON for \$550,000 in early 2013.¹⁷ As a result of the sale, Groton Utilities will be required to pay off the remaining debt of \$27.5 million via annual installments that began at \$2.6 million and will decrease by about \$100,000 each year over the next 14 years.¹⁸

The current, privately owned incarnation of TVC offers customers an array of standalone and bundled broadband, television, and telephone services.¹⁹ Its broadband packages range from an asymmetrical 6.6 Mbps connection for \$29.99 per month, to an asymmetrical 55 Mbps connection for \$59.99 per month.²⁰ As of 2012, TVC had 8,000 customers²¹ across a service territory that covered at least 38,000 homes.²²

Community Impact

Benefits that might have flowed from this GON have been overshadowed by the financial difficulties that have faced this network. It also appears that the network has not had a discernible impact on local employment. Groton’s unemployment rate has been largely unchanged since deployment of the network and has generally tracked fluctuations in the national labor market.²³ Its relatively small subscriber base demonstrates the GON did not achieve one of its core goals: to compete directly with incumbent ISPs. On the contrary, the municipal system was weakened by the very competitive forces that the city thought were lacking.²⁴

The large amount of debt accrued to build this system has had several negative impacts on residents. First and foremost, the town of Groton, even after selling off its failing asset, remains responsible for paying off tens of millions of dollars in debt. Due to the city’s use of general obligation bonds, this onus falls directly on residents, either via increased taxes, fewer municipal services, or higher electricity rates.²⁵ Second and related, Groton’s credit rating has been negatively impacted by the failed network. Moody’s downgraded Groton’s credit rating as a result of the failing municipal network,²⁶ and only after selling the GON to CTP was the city’s credit outlook upgraded from “negative” to “stable.”²⁷

Assessment

The rise and fall of the GON in Groton highlights a number of assumptions often made by local officials and others who advocate in favor of municipal broadband deployment.

First, the size of the debt amassed by the city was driven up by the actions of city government and local utility officials, many of whom viewed the GON as a financial panacea that would be able to self-sustain and generate profits to help cross-subsidize other investments. As a result, the reasoning offered in support of the GON became a moving target. Initially, the GON was pitched as a wholesale network that would provide the utility with a new vehicle for making money to offset a decline in electricity revenues.²⁸ But the network eventually evolved into a commercial enterprise that would compete directly with incumbent ISPs. Such quixotic maneuvering drove up costs and greatly enhanced the risk exposure

for residents, whose tax dollars were offered as collateral in exchange for the tens of millions of dollars in bond debt needed to fund deployment.

Second, expectations for the financial sustainability of the Groton GON appeared to be based on a small consumer survey undertaken in 2001, which found a majority of customers would consider switching cable providers if a competitor entered the market.²⁹ Such apparent pent-up demand for an alternative drove the development of a business plan largely hinged on the GON's ability to attract a substantial portion of these disillusioned customers and grow a subscriber base that would generate revenues sufficient to cover future deployments. Officials, however, failed to see the many risks inherent in this plan. An editorial in a local paper at the time identified these risks and called for caution: "... there is financial risk involved. Profits are not guaranteed, the business is competitive and market conditions can change dramatically in a short time."³⁰

Third, the dynamism in the market proved prescient as the wider communications marketplace began to change in fundamental ways in the early and mid-2000s. Although competition in the market for video and broadband services might have been nascent in 2001, when the utility began to develop its plans for the GON, the advanced communications space began to proliferate in significant and profound ways shortly thereafter.³¹ At the time, city officials and the utility were so focused on the promise of a municipal network that they failed to account for the rapid emergence of intermodal competition. Consequently, the resulting business model and the many predictions for success and viability were predicated on a static view of the market. But the marketplace and organic market forces soon addressed whatever shortcomings the city and utility were attempting to "fix" with its GON.

Endnotes

- 1 See, e.g., Michael Costanza, *Groton Utilities Considering Telecommunications Service*, Oct. 22, 1999, *The Day*, available at <http://news.google.com/newspapers?nid=1915&dat=19991022&id=QQchAAAAlBAJ&sjid=eXYFAAAAlBAJ&pg=5556,4321864> (“*Groton Utilities Considering Telecommunications Service*”).
- 2 *Id.*
- 3 See Michael Costanza, *Groton City Backs Utilities’ Proposal to Provide Telecommunications Service*, Nov. 2, 1999, *The Day*, available at <http://news.google.com/newspapers?nid=1915&dat=19991102&id=RQohAAAAlBAJ&sjid=ynYFAAAAlBAJ&pg=4629,187783>;
- 4 See e.g., Tara Bahrapour, *Bid to Stop Groton*, June 5, 2001, *N.Y. Times*, available at <http://www.nytimes.com/2001/06/05/nyregion/metro-business-briefing-bid-to-stop-groton.html> (noting that “Southern New England Telecommunications has appealed an April ruling by the Department of Public Utility Control in Connecticut that would allow Groton Utilities to build a 32-mile fiber-optic network providing Internet access and other services in the Groton area.”).
- 5 See Gladys Alcedo, *Hearing Planned On Proposal For New Cable Service*, March 11, 2003, *The Day*, available at <http://www.theday.com/article/20030311/DAYARC/303119938/0/SEARCH> (“*Hearing Planned*”).
- 6 Competition in the U.S. video marketplace was still developing in the late 1990s and early 2000s. Satellite television service was becoming increasingly popular, but market entry by telephone companies had yet to materialize in any significant way. Of course, over the next decade, video choices would proliferate with the continued rise of satellite, the emergence of video services by telecom companies like Verizon and AT&T, and the rapid emergence of IP-enabled video. For additional discussion and analysis of this transformation, Compare *In the Matter of Annual Assessment of the Status of Competition in the Market for the Delivery of Video Programming*, Eighth Annual Report, 17 FCC Rcd 1244, FCC 01-389 (rel. Jan. 14, 2002), with *In the Matter of Annual Assessment of the Status of Competition in the Market for the Delivery of Video Programming*, Fifteenth Annual Report, 28 FCC Rcd 10496, FCC 13-99 (rel. July 22, 2013).
- 7 *Hearing Planned.*
- 8 See *Editorial: City Utilities Goes Modern*, July 2, 2001, *The Day*, available at <http://news.google.com/newspapers?id=C5tGAAAAlBAJ&sjid=7PgMAAAAlBAJ&pg=2445,251176&dq=groton+utilities+telecom+network+resident+vote+approve+1999&hl=en> (endorsing the proposed GON but urging caution) (“*Editorial: City Utilities Goes Modern*”).
- 9 See *City of Groton, Connecticut, General Obligation Bonds, Issues of 2006*, at p. 10, Electronic Municipal Market Access, Municipal Securities Rulemaking Board (Feb. 7, 2006), available at <http://emma.msrb.org/MS244149-MS219457-MD427024.pdf> (“*Groton General Obligation Bonds, Issues of 2006*”).
- 10 *Id.*
- 11 See *Utilities Commission Meeting Minutes*, at p. 11, City of Groton (Nov. 23, 2004), available at <http://www.cityofgroton.com/docs/minutes/ucommission/2004/ucommission11-23-04.pdf>.
- 12 *Groton General Obligation Bonds, Issues of 2006* at p. 10.
- 13 See, e.g., Deborah Straszheim, *Thames Valley Communications Transfers Ownership of Cable Company*, Feb. 2, 2013, *Groton Patch*, available at <http://groton.patch.com/groups/politics-and-elections/p/thames-valley-communications-transfers-ownership-of-cbe9bb6eabc>
- 14 *Hearing Planned.*
- 15 See Thames Valley Communications, About, <http://www.tvconnect.com/about-us>.
- 16 See, e.g., Greg Smith, *Groton Utilities’ Venture Into Cable an Ambitious Idea that Didn’t Pan Out*, Dec. 2, 2012, *The Day*, available at <http://www.theday.com/article/20121202/NWS01/312029942/Groton-Utilities%27-venture-into-cable-an-ambitious-idea-that-didn%27t-pan-out> (“*Ambitious Idea that Didn’t Pan Out*”).
- 17 See Greg Smith, *Original Bidder to Buy Groton Cable Company, but at Higher Price*, Jan. 15, 2013, *The Day*, available at <http://www.theday.com/article/20130115/NWS01/130119838/1047>.
- 18 *Id.*
- 19 See TVC, Rate Card, <http://www.tvconnect.com/wp-content/uploads/2013/11/RateCard.pdf>.
- 20 *Id.*
- 21 Groton’s annual report does not make clear which services these customers had purchased. See *Comprehensive Annual Financial Report, Fiscal Year Ending in 2012*, at p. iii, Dept. of Finance, City of Groton, Connecticut, available at <http://emma.msrb.org/ER637248-ER493540-ER896400.pdf>.
- 22 *Hearing Planned* (the 38,000 home estimate stems from a 2001 assessment by the city regarding the proposed GON).
- 23 See Groton, Connecticut Unemployment Rates, http://ycharts.com/indicators/groton_ct_unemployment_rate.
- 24 See, e.g., *Ambitious Idea that Didn’t Pan Out*.
- 25 *Groton General Obligation Bonds, Issues of 2006* at p. 1.
- 26 See *Rating Action: Moody’s Assigns Aa3 Rating to City of Groton’s (CT) \$23.2 million G.O. Bonds, Issue of 2013 Series A and B; Outlook Revised to Stable from Negative*, March 21, 2013, Moody’s, available at https://www.moody.com/research/Moodys-assigns-Aa3-rating-to-City-of-Grotons-CT-232--PR_269226 (“*Outlook Revised to Stable from Negative*”). See also *Rating Action: Moody’s Downgrades the City of Groton’s (CT) Long Term General Obligation Rating to Aa3 from Aa2; Negative Outlook Affirmed*, June 4, 2012, Moody’s, available at https://www.moody.com/research/Moodys-downgrades-the-City-of-Grotons-CT-long-term-general--PR_247614.
- 27 *Outlook Revised to Stable from Negative.*
- 28 *Groton Utilities Considering Telecommunications Service.*
- 29 *Hearing Planned.*
- 30 *Editorial: City Utilities Goes Modern.*
- 31 For additional discussion and analysis, see *supra*, section 3.1.1.

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