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UNDERSTANDING THE DEBATE OVER GOVERNMENT-OWNED BROADBAND NETWORKS:

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

Monticello Case Study

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Monticello, Minnesota

The municipal broadband network in Monticello, Minnesota, provides a case study illustrating the volatile reality of many GONs.

Background

Monticello began investigating the feasibility of building a city-owned fiber-optic broadband network in 2005.¹ A task force was established and explored how the city might pay for the network without having to implement a tax levy.² The study concluded such a network was feasible, and the Monticello City Council approved a plan to deploy the GON in September 2006.³ In 2007, the town held a legally mandated referendum to approve the sale of bonds that would be used to fund network deployment; the item passed by a margin of nearly three to one.⁴

Shortly thereafter, the local incumbent ISP, TDS Telecom, sued to enjoin the city from using a bond issuance to fund the GON. The case delayed construction, but was decided in favor of Monticello.⁵ When the case was still before the court, the city reached out to TDS and raised the idea of collaborating in the construction of a citywide fiber-optic network.⁶ City officials reasoned that such a partnership would help to reduce costs and assure more efficient deployment.⁷ TDS ultimately declined, reasoning that the proposed approach would be “anti-competitive” and might raise antitrust concerns.⁸

Construction of the GON began in earnest in 2009 after the case was decided in the city’s favor, and FiberNet, the official name of the GON, began offering broadband service to customers in the spring of 2010.⁹

Cost and Financing

In 2008, Monticello issued two series of bonds totaling \$26,445,000.¹⁰ The bonds have interest rates of 6.5 and 6.7 percent¹¹ and reach full maturity in 2031.¹² These funds were secured solely by the net revenues of Monticello FiberNet.¹³ In terms of allocating the funds, the city estimated that actual construction of the GON would cost \$16,762,765 and take 30 months to complete.¹⁴ Ongoing operational costs and unanticipated expenses have proven to be substantial and in excess of initial estimates.¹⁵ Combined with tepid demand for its services, the GON encountered significant financial difficulties.

The Network

Monticello FiberNet is a city-owned 151-mile FTTH network that offers broadband, telephone, and television services to municipal buildings, schools, homes, and businesses.¹⁶ Major business decisions are made by Monticello’s advisory board and general manager.¹⁷ The advisory board consists of five voting

Monticello, Minnesota At-A-Glance



City Population: 12,964 (2012)

Year of Network Launch: 2010

Current Status: Built

Number of subscribers: 1,270

Revenues: \$1.756 Million

Operating Expenses: \$2.292 Million

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

members: the mayor, a council member, and three community members; the city administrator and the general manager of FiberNet are non-voting members.¹⁸ The general manager oversees employees, creates annual budgets, and is responsible for managing day-to-day activities.¹⁹

The network is fully operational. Residents can choose from an array of stand-alone and bundled offerings. Examples include a symmetrical 10 Mbps broadband connection for \$29.95 per month, a symmetrical 30 Mbps connection for \$52.95 per month, and a symmetrical 50 Mbps connection for \$95.35.²⁰ These prices decrease with the addition of other services. For example, the monthly price of the 10 Mbps connection decreases to \$24.95 with the addition of voice and television services.²¹

FiberNet has worked hard to grow its customer base since the service went live in 2010. As of March 2013, the network had 1,010 voice service customers, 1,270 Internet customers, and 970 TV customers.²² One hundred and thirty of FiberNet's customers are businesses.²³ As a result of the lack of a strong customer base, the system appears not to be viable. In July 2012, FiberNet defaulted on its bond repayment because the city was unable to make "a monthly deposit into a debt service account as required by bond indenture."²⁴ The network continued to be in default and failed to make another scheduled payment in December 2012.²⁵ As of March 2013, total quarterly revenues were down to \$439,141, which totals \$1.75 million on an annualized basis.²⁶

The Monticello GON was initially funded by revenue bonds that explicitly limited the city's liability, but ongoing financial difficulties have forced the city to intervene on several occasions.²⁷ For example, a recent audit of city financials (for fiscal year 2011) revealed several outstanding inter-fund loans to FiberNet, including a \$3.1 million loan from the city's Liquor Fund and \$323,000 from the General Fund.²⁸ In addition, "management report[ed] that inter-fund loans [grew] to \$4.1 million [by September 2012], and expect[ed] additional monthly support of up to \$60,000 through the end of fiscal 2012."²⁹ Even with city-sponsored cross-subsidization, the network continues to struggle financially. In the first quarter of 2013, FiberNet reported an operating loss of \$134,278.44 and a negative cash flow of \$159,644.49.³⁰ As a result, the city's credit rating was downgraded in September 2012.³¹

These losses and default on bond repayment obligations resulted in bondholders suing the city in late 2012.³² In response, the city proposed a settlement that would repay bondholders 22 cents on the dollar, or \$5.75 million of the over \$26 million that was raised during the initial bond sales.³³ If accepted by bondholders, most of the \$5.75 million would "become a general city obligation, payable from existing funds or funds generated by issuing a new bond."³⁴

Community Impact

Evidence of FiberNet's positive impacts is limited as the city continues to address the significant financial shortcomings discussed above. GONs advocates have not attempted to frame the Monticello network as a driver of local economic development.

Proponents of the GON have argued that it has sparked renewed competition among ISPs in the city.³⁵ One group estimated FiberNet saves Monticello \$240,000 a year, and arrived at this figure by making a number of assumptions about hypothetical savings of individual households that have benefited from competing ISPs' lower prices.³⁶ While these service providers have adjusted their offerings in recent years, it can be argued that any perceived "savings" are outweighed by the substantial cost the city incurred for having to financially support the GON. Despite growing acceptance that FiberNet is negatively impacting city finances, some GONs advocates argue strongly that the municipal network is worthwhile because of its impacts on local competition.³⁷

Proponents of this view tend to overlook the trends in broadband innovation over the last decade. Connection speeds across the country have consistently increased while prices have decreased and the

diversity of offerings has multiplied.³⁸ Wireless broadband has further bolstered intermodal competition and provides Monticello residents with multiple options for getting online.³⁹ While some credit the Monticello GON with causing service improvements by local incumbents, the city could have saved millions of dollars and avoided such enormous risk by appreciating that organic forces were shaping the market as a function of the demands and actual usage patterns of residents.⁴⁰ Indeed, many citizens have expressed resentment toward the city government for getting into the business of broadband and failing.⁴¹

Assessment

The financial struggles of the GON in Monticello highlight a more general concern about the capability of municipal governments to successfully operate a GON. GON proponents argue that local government can be as nimble as the private sector when it comes to funding a new network and adjusting to competitive pressures. In light of the preceding analysis, Monticello appears to have been ill prepared to deal with market pressures and suffered as a result. The city's initial plan for the GON assumed that market conditions would not change once it entered the market.⁴² When its competitors reduced prices, Monticello did not alter its plan and chose instead to adhere to the road map that had already passed muster with city officials. The result has been financial distress and support of the argument that municipalities are often ill equipped to compete in well-functioning dynamic markets.

Infrastructure Needs in Minnesota

The financial difficulties facing the city and FiberNet raise the possibility that the GON will require general revenue expenditure that could be put to better and more productive uses. Infrastructure throughout the state, for example, is poorly rated and in desperate need of investment by state and local government. More than half the roads in the state are of poor or mediocre quality, while its schools have nearly \$4 billion in infrastructure funding needs.⁴³ Billions of dollars in additional funding are needed to shore up other critical infrastructure, like the state's drinking and wastewater systems.⁴⁴

Endnotes

- 1 See *City of Monticello, Minnesota, Telecommunications Revenue Bonds, Series 2008*, at p. 20, Electronic Municipal Market Access, Municipal Securities Rulemaking Board (June 19, 2008), available at <http://emma.msrb.org/MS271839-MS268494-MD531794.pdf> (“*City of Monticello, Minnesota, Telecommunications Revenue Bonds, Series 2008*”).
- 2 *Id.*
- 3 *Id.*
- 4 *Id.* at p. 21.
- 5 See *Bridgewater Telephone Co. v. City of Monticello*, File No. 86-CV-08-4555 (Wright Cty. Dist. Ct., June 2, 2009).
- 6 See *Letter from Jeff O’Neill, City Administrator, to Tom Ollig, TDS*, July 17, 2008, available at http://www.muninetworks.org/sites/www.muninetworks.org/files/TDSLetter_joint%20fiber%20install_071708.pdf.
- 7 *Id.*
- 8 See Mike Schoemer, *TDS Turns Down City’s Offer for Cooperative Installation*, Aug. 21, 2008, *Monticello Times*, available at <http://www.muninetworks.org/sites/www.muninetworks.org/files/2008-TDS-Turns-Down-City.pdf>.
- 9 See *City of Monticello, Minnesota, General Obligation Refunding Bonds, Series 2011*, at p. A-10, Electronic Municipal Market Access, Municipal Securities Rulemaking Board (Sept. 15, 2011), available at <http://emma.msrb.org/EP571899-EP448885-EP848794.pdf>.
- 10 *City of Monticello, Minnesota, Telecommunications Revenue Bonds, Series 2008* at p. i.
- 11 *Id.*
- 12 *Id.* at 4.
- 13 *Id.* at 10.
- 14 *Id.* at 21.
- 15 For a recent accounting, see *City of Monticello, Mn, Telecommunications Revenue Bonds, Series 2008, Quarterly Report for Period Ending March 31, 2013*, Electronic Municipal Market Access, Municipal Securities Rulemaking Board (2013), available at <http://emma.msrb.org/EA525726-EA409489-EA806402.pdf>.
- 16 See *City of Monticello, Minnesota, Telecommunications Revenue Bond, 2012 Annual Report*, at p. 3, Electronic Municipal Market Access, Municipal Securities Rulemaking Board (2013), available at <http://emma.msrb.org/EA541341-EA422012-EA819011.pdf>.
- 17 *Id.* at p. 5.
- 18 *Id.*
- 19 *Id.*
- 20 See *City of Monticello, FiberNet, Residential Pricing*, <http://monticellofiber.com/ResidentialServices.cfm?ID=91&PID=103&siteID=1>.
- 21 *Id.*
- 22 See *City of Monticello, Mn, Telecommunications Revenue Bonds, Series 2008, (FiberNet Monticello Project), Quarterly Report for Period Ending March 31, 2013*, at p. 6, Electronic Municipal Market Access, Municipal Securities Rulemaking Board (2013), available at <http://emma.msrb.org/EA525726-EA409489-EA806402.pdf> (“*City of Monticello Quarterly Report for Period Ending March 31, 2013*”).
- 23 See Tom Meersman, *Monticello’s Model Broadband Effort in Peril*, June 7, 2012, *Star Tribune*, available at <http://www.startribune.com/local/west/157992065.html?page=all&prepage=1&c=y#continue> (“*Monticello’s Model Broadband Effort in Peril*”).
- 24 See *Comprehensive Annual Financial Report*, at p. 12, City of Monticello, Minnesota (Dec. 2012), available at http://www.ci.monticello.mn.us/vertical/Sites/%7B46185197-6086-4078-ADDC-0F3918715C4C%7D/uploads/2012_Monticello_CAFR_6000.pdf.
- 25 *Id.*
- 26 See *City of Monticello, Mn, Telecommunications Revenue Bonds, Series 2008, (FiberNet Monticello Project), Quarterly Report for Period Ending March 31, 2013*, at p. 3, Electronic Municipal Market Access, Municipal Securities Rulemaking Board (2013), available at <http://emma.msrb.org/EA525726-EA409489-EA806402.pdf> (“*City of Monticello Quarterly Report for Period Ending March 31, 2013*”).
- 27 See Andrea Stenhoff, *Moody’s downgrades to A2 from Aa3 the GOULT rating for City of Monticello (MN); concurrently downgrades lease revenue debt to A3 from A1*, Sept. 28, 2012, Moody’s Investors Service, available at http://www.moody.com/research/Moodys-downgrades-to-A2-from-Aa3-the-GOULT-rating-for-Rating-Update--RU_900688861 (“*Moody’s downgrades City of Monticello*”).
- 28 *Id.*
- 29 *Id.*
- 30 *City of Monticello Quarterly Report for Period Ending March 31, 2013* at p. 4.
- 31 *Moody’s downgrades City of Monticello*
- 32 See Tim Hennigar, *Monticello Council Approves \$5.75 Million Proposed FiberNet Bondholder Settlement*, June 17, 2013, *Monticello Times*, available at <http://monticellotimes.com/2013/06/17/monticello-council-approves-5-75-million-proposed-fibernet-bond-settlement/> (“*Monticello Council Approves \$5.75 Million Proposed FiberNet Bondholder Settlement*”).
- 33 See *Bondholders to Take Loss on Monticello Broadband*, Aug. 19, 2013, *Associated Press*, available at <http://www.inforum.com/event/article/id/409548/>.
- 34 *Monticello Council Approves \$5.75 Million Proposed FiberNet Bondholder Settlement*.
- 35 See, e.g., Chris Mitchell, *A Closer Look at FiberNet Monticello*, June 8, 2012, *Community Broadband Networks, Institute for Local Self-Reliance*, available at <http://www.muninetworks.org/content/closer-look-fibernet-monticello>.
- 36 *Id.*
- 37 See, e.g., Christopher Mitchell, *What if FiberNet Monticello Had Been Canned in 2008?*, June 29, 2012, *Community Broadband Networks, Institute for Local Self-Reliance*, available at <http://www.muninetworks.org/content/what-if-fibernet-monticello-had-been-canned-2008> (“We continue to believe that Monticello made the smart choice in proceeding with its network, even in the face of all the adversity they have had. If it were possible to total up the many varied benefits to the community from the additional investment, choices, discounts, and multiplier effects, we believe it would significantly outweigh the negatives.”); Christopher Mitchell, *Monticello Moves Closer to Settlement with Bondholders*, June 20, 2013, *Community Broadband Networks, Institute for Local Self-Reliance*, available at <http://muninetworks.org/content/monticello-moves-closer-settlement-bondholders> (“We continue to see FiberNet Monticello as benefiting the community on the whole”) (“*Monticello Moves Closer to Settlement with Bondholders*”).

38 For data and discussion, *see supra*, section 3.1.1.

39 The National Broadband Map reveals that every resident in Wright County, Minnesota, where Monticello is located, has access to at least three wireless broadband providers, while the vast majority has access to six. *See* National Broadband Map, Summarize: Wright County, MN, <http://www.broadbandmap.gov/summarize/state/minnesota/county/wright>.

40 The city was initially persuaded into exploring a municipal communications network by local business owners who were frustrated with unreliable telephone service. As discussed above, FiberNet has attracted only about 130 business customers to date. *Monticello's Model Broadband Effort in Peril*.

41 *See, e.g.*, Walt Markling, *Letter: FiberNet Remains a Costly Venture for City Residents in Monticello*, Feb. 28, 2013, Monticello Times, available at <http://monticellotimes.com/2013/02/28/letter-fibernet-remains-a-costly-venture-for-city-residents-in-monticello>.

42 *See* Nate Anderson, *Want 50Mbps Internet in Your Town? Threaten to Roll Out Your Own*, Oct. 27, 2009, Ars Technica, available at <http://arstechnica.com/tech-policy/2009/10/want-50mbps-internet-in-your-town-threaten-to-roll-out-your-own/>.

43 *See* ASCE Infrastructure Report Card 2013, States—Minnesota, <http://www.infrastructurereportcard.org/a/#p/state-facts/minnesota>.

44 *Id.*

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