AFN Option Evaluation Criteria

1. Competitive Environment

   - Sale

     Can only be accomplished if system is not sold to Charter Communications

   - Spin Off

     Yes

   - Spin Off/JPRF

     Yes

   - Open Carrier

     Yes

2. Financial impact to community

   - Sale

     Could result in an increase in rates resulting in increased cost to the consumer

     $8 to $5 million in debt would remain

   - Spin Off

     Absent profit motive, it is anticipated that rates would remain below current market rates

     $8 to $15.5 million in net debt would remain but could decrease in future years depending on the financial success of the new entity

   - Spin Off/JPRF

     Would depend on the business philosophy of JPRF

     Approximately $10 million in net debt would remain (based on JPRF letter of interest of December 20, 2005) but could decrease in future years depending on future uses of the system by JPRF

- Open Carrier

  Absent profit motive, it is anticipated that rates could be below current market rates for internet services

  Amount of debt that would remain has not been determined at this time

3. Financial impact on city organization

   - Sale

     Loss of $400,000 in central service fees that cannot be offset with reductions in expenditures

   - Spin Off

     Loss of $400,000 in central service fees that cannot be offset with reductions in expenditures

     Revenue of rental of space to spin off organization to be negotiated

   - Spin Off/JPRF

     Loss of $400,000 in central service fees that cannot be offset with reductions in expenditures

     Revenue of rental of space to spin off organization to be negotiated

   - Open Carrier

     Loss of $400,000 in central service fees that cannot be offset with reductions in expenditures

4. Citizen access to system

   - Sale

     Determined by franchise agreement with city

   - Spin Off

     Determined by franchise agreement with city

   - Spin Off/JPRF

     Determined by franchise agreement with city

- Open Carrier

  Access to "over the air" television signals would be free and dependent on access to the network and, in some situations, ability to make connection from the street to the home. Access to the internet would be at a reduced cost. Ability to take advantage of reduced cost would be limited by access to the network and ability to make connection from the street to the home.

5. Public ownership of infrastructure

   - Sale

     May not be feasible or could have an impact on sale price

   - Spin Off

     Yes

   - Spin Off /JPRF

     Yes

   - Open Carrier

     Yes

6. Responsiveness to community needs/concerns

   - Sale

     Market Driven

   - Spin Off

     Would need to be market driven but less so in comparison to sale due to non profit approach. Board structure and appointment process could have an impact on responsiveness to community concerns

   - Spin Off/JPRF

     Would depend on the business philosophy of JPRF

   - Open Carrier

     Yes – assuming the open carrier is managed by the city of Ashland

7. Future financial risk/gain

    - Sale

      None

    - Spin Off

      Future risk exists if AFN is returned to the city if the spin off organization fails. Future gain exists if agreement with the spin off allows for revenue to the city to increase based on the financial success of the spin off

    - Spin Off/JPRF

      Future risk exists if AFN is returned to the city if JPRF fails. Future gain exists if agreement with the spin off allows for revenue to the city to increase based on increased use of the system by JPRF

    - Open Carrier

      Represents the highest risk and gain of all options due to the need to make future investments and the financial success or failure of those investments

8. Ability to meet current and future needs of the community

    - Sale

      Market Driven

    - Spin Off

      Would be dependent on the financial ability of the spin off organization to make investments in the system

    - Spin Off/JPRF

      Would be dependent of the financial ability of JPRF to make investments in the system and the business philosophy of JPRF

    - Open Carrier

      Would be dependent on the financial ability to make investments in the system

9. Ability to meet current and future needs of the city organization

- Sale

  Current needs can be identified and met through negotiations with purchaser of the system. Future needs are difficult to predict and would be subject to future negotiations. The city would be in a better position to meet future needs if infrastructure remains in city ownership

- Spin Off

  Current needs can be identified and met through negotiations with spin off organization. Future needs are difficult to predict and would be subject to future negotiations. The city would be in a good position to meet future needs because the infrastructure remains in city ownership

- Spin Off/JPRF

  Current needs can be identified and met through negotiations with spin off organization. Future needs are difficult to predict and would be subject to future negotiations. The city would be in a good position to meet future needs because the infrastructure remains in city ownership

- Open Carrier

  The city would be in a good position to meet future needs because the infrastructure and management of the system remains in city ownership.

10. Ability to maintain an open system for access to the internet (Multiple Internet Service Provider's (ISP's))

    - Sale

      No

    - Spin Off

      Yes – if made a requirement of the spin off organization

    - Spin Off/JPRF

      JPRF has indicated they would continue to allow current ISP's to operate on the system

    - Open Carrier

      Yes

AFN Options Committee Report

Attach II

MEMO

TO: Ashland City Council
FROM: AFN Options Committee
DATE: November 17, 2005
RE: Initial Report

The purpose of this report is to describe the activities of the AFN Options Committee (the "Committee") since its formation, and to present what it believes are the city's best options with regard to AFN.

The Committee has met in formal session 11 times since its initial meeting on August 2, 2005. During these meetings, the Committee received significant public input. Moreover, the Committee had discussions with other parties about the future of AFN. These parties included: 1) several of the local ISPs; 2) Hunter Communications; 3) the Programming Committee; 4) AFN's former Director; and 5) the Director of the Spanish Fork, Utah system.

In addition to these public meetings, the Committee conducted extensive due diligence with both City administrators and AFN staff. The members of the Committee collectively spent several hundred hours not only in discussions with these individuals, but in reviewing relevant financial, market and other information on AFN, its competitors and comparable municipal systems in other regions of the country. The Committee also reviewed valuation data for certain publicly-held companies engaging in the provision of CATV and Internet services and applied such information to derive a theoretical valuation for AFN.

Committee members also interviewed current and former directors of Ashland Community Hospital, the director of OSF and members of the Mt. Ashland Board regarding these public-private partnerships, their establishment, business models, legal relationship to the City and mission of service to the community. The purpose of these interviews was to better understand how community experience with these models might apply to a spin-off and how such a business can fare in a competitive market.

During this process, the Committee kept in mind the context of AFN's current situation, including the original rationale for its creation. Key reasons given at the time for AFN were: 1) the need to quicken the pace of the introduction of broadband services to Ashland; 2) the use of the system to attract new employers to the community; 3) the retention of local control over content; 4) the avoidance of a communications final mile defacto corporate monopoly; and 5) the benefits of competition to the community at large. However, not only did the original construction cost run significantly over budget, but Charter became an unexpectedly fierce competitor, adversely impacting AFN's subsequent financial performance. Additionally, major

employers, projected to be an important source of revenues for AFN, are currently not an important source of AFN revenues, with little prospect of improvement in sight.

CURRENT SITUATION

Community

The City of Ashland now finds itself with a citizenry that is extremely divided and increasingly vocal over the future of AFN. Ballot measures forcing divestiture have been threatened and the City finds its alternatives narrowing with regard to funding AFN's annual cash deficits due to citizen protests. Indeed, other municipalities where such systems enjoy broad community support have significantly outperformed AFN.

Industry

Layered on top of these community dynamics are certain industry dynamics which are perhaps more pronounced today versus the time of AFN's conception. These industry dynamics include:

- Rapid technological change;
- High degree of capital intensity;
- Deep-pocketed competitors;
- Intense and growing near-term competition from alternative providers (e.g. satellite, wireless, bundled telecom); and
- Uncertain longer-term competitive environment, since it is unclear whether satellite and/or RF distribution technology will be able to provide all future video requirements, and if not, this could create significant potential future value for AFN's hardwired bandwidth.

AFN

AFN's historical financial performance has been disappointing but understandable given the tenacious competition it has encountered from Charter as well as from other providers. The result of this competition has been a stalemate somewhat analogous to the situation encountered on the Western front in World War I: prolonged "trench warfare" with neither side able to gain significant additional ground (i.e., market share). Our understanding of AFN's situation includes the following points:

- AFN is currently performing near breakeven on an operating basis; however, operating expenses are significantly burdened by the amount of the City's annual Central Services Fee;
- If AFN were sold, most of the annual $500,000 Central Services Fee it pays would remain as current staff are shifted to other responsibilities;
- AFN is significantly cash negative after debt service, with such payments scheduled to increase;

- The City's ability to subsidize AFN is certain to be controversial and, therefore, difficult, due to increasing opposition by some of Ashland's citizenry;
- AFN does not currently offer either clearly differentiated products or programming;
- AFN will require additional capital to become competitive in programming, products and customer service;
- AFN as it currently operates appears to have limited ability to capture additional market share even if it were to offer differentiated and competitive products and services;
- AFN is under constant rate pressure from Charter, thereby limiting its ability to increase rates in order to earn a margin more consistent with those earned in other parts of the country;
- AFN's past actions to improve profitability in response to the Navigant study failed to produce the desired results;
- AFN's decision-making process is particularly cumbersome and inefficient when compared to that of private enterprise;
- AFN is competitively disadvantaged because all deliberations are made in full public view; and
- AFN currently does not have service available to 10% of the Ashland market.

OPTIONS

As a result of the findings noted above, the Committee has reviewed a number of options. Unfortunately, there is no perfect alternative, as each option has plusses and minuses that will be either accepted or rejected by opposing factions within the community. The following list shows the major options currently considered to be plausible by the Committee. In addition to these options, the Committee explored a myriad of sub-options. Major options considered were:

- Sale of AFN;
- Spin-off of AFN to another non-profit entity ("Spin-Off");
- Continued City ownership of AFN with an enhancement of products and programming ("Maintain and Enhance");
- Convert AFN to a Common Carrier
- Purchase of Charter's Ashland subscriber base ("Purchase");
- Status Quo; and
- Immediate Shutdown.

In an effort to winnow this list to the best possible options, the list was further broken down according to financial impact and likely business risk. This simple illustration is shown in Appendix A. It is the opinion of the Committee that the Status Quo, Immediate Shutdown, and Purchase options are either financially untenable, entail significant controversy or both. It is also the opinion of the Committee that significant controversy will lead to substantial delay which will cause a substantial decrease in AFN's value. Moreover, although the Committee was intrigued by the Common Carrier alternative, we concluded that this option is not germane to the fundamental organizational and debt service issues and possesses so many unknowns that we did

not adequately analyze this option to make a recommendation. Instead, this option should be explored further under either the Maintain and Enhance, or Spin-Off options, should either of those two options be chosen.

While we would be pleased to discuss the four rejected options in more detail, the Committee has decided to focus on the remaining three options: 1) Continued city ownership of AFN with a new director and enhancement of products and services ("Maintain and Enhance"); 2) Spin-off of AFN to a non-profit entity ("Spin-Off"); and 3) Sale of AFN. Each of these options will be discussed in turn.

One possible way to evaluate each of the three remaining options is to consider the following questions:

1. The Committee believes that the key question for the Council to decide is whether the future savings, local content control and local service are worth leaving taxpayer funds at risk, and perhaps more likely, adding new taxpayer funds to this burden;
2. Using the three-pronged course of action recommended on pages 10 and 11 of this document, the Council should consider these actions in light of the expected sale price, the amount of debt reduction and the risks of continuing or terminating AFN; and
3. Should the Council decide to continue funding AFN with taxpayer monies, then it is the strong recommendation of this Committee that the Spin-Off option be exercised.

Maintain and Enhance Option

The primary change under the Maintain and Enhance Option would be the hiring of a seasoned executive with CATV and Internet experience. However, even were the salary offered to be increased to attract such person, the Committee believes that ***the Maintain and Enhance Option is the least attractive alternative of the three options selected for further review and should not be pursued***. The primary reasons for this opinion are as follows:

- The new AFN director will become part of a management structure geared towards stewardship and maintenance, rather than competition and cost control;
- The new AFN director will likely require significantly more autonomy and less oversight in matters of programming, staffing, and rate setting than has been acceptable to the City Council;
- As a public official, the new director may be constrained in his/her role of speaking as an advocate of AFN's community mission;
- AFN faces significant organizational development and communication issues, such as different, unresolved opinions between council, staff, and the programming committee as to what policy and strategies can be decided and executed, by whom, and how. These issues are systemic, not easily changeable and to some degree, reflect Ashland's culture.
- AFN will remain subject to public meetings laws, public procurement and public process in general, severely constraining its ability to compete and continuing the inefficiency of the public decision process;
- AFN, by its nature, will continue to consume a disproportionately large amount of attention from the City Counsel and Staff relative to its size and budget;

- AFN, as a City entity, may be precluded from entering profitable business partnerships that could enhance revenues without putting such initiatives out to bid;
- Debate about AFN's existence will likely remain a highly controversial issue for years to come, further adversely impacting public perceptions about AFN's fortunes and limiting its potential;
- Despite the new director, the City may not be able to operate the business any better than in the past, despite potential new revenue sources;
- Charter will continue to be a tenacious competitor, putting a ceiling on the amounts able to be charged by AFN. Furthermore, given the tremendous amount of industry consolidation, Charter and/or its CATV operations may also be sold to an even more formidable competitor;
- AFN will require additional funds to provide competitive products and services like HDTV and DVR, but still may not be able to capture any additional market share;
- The recommendations of the Navigant study failed to produce any significant increase in revenues: there can be no assurance that future efforts to increase revenues will be successful either;
- The City will still be burdened with its $15.5 million debt obligation, will likely have to continue subsidizing AFN if rates can not be raised sufficiently, and will have to spend additional funds to upgrade the system periodically.

In contrast, the Committee found very few benefits to pursuing this option:

- Because continued competition with Charter and others is assured, AFN as well as Charter subscribers will likely get a break in the rates they pay versus others in the Rogue Valley;
- Local content and service control continues; and
- The community will retain an asset for future applications.

As a consequence of these findings, the ***Options Committee strongly recommends against pursuit of the Maintain and Enhance Option as it is likely to result in continued financial shortfalls, continued requirements for City subsidies, limited, if any, progress in capturing additional market share, and a further decrease in the value of the asset. Moreover, and perhaps of equal importance is the likelihood of continued community divisiveness over AFN.***

Spin-Off

In contrast to the likely outcome of the City retaining ownership of AFN and seeking to improve its products and services, the Spin-Off option provides the community with a higher, but not necessarily quantifiable, probability of success. Not only would the community retain local control over content, but the problems associated with being a public entity subject to public meeting law requirements and financial disclosures would be eliminated. As a result, the Committee believes that this option, unlike the Maintain and Enhance Option, should be seriously considered by the City Council.

The pursuit of the Spin-Off Option would require that the City create a non-profit entity for providing telecommunications services for the Ashland community as a public service. This new non-profit entity would have the city as its sole member, similar to the Community Hospital, with a Board of Directors initially appointed by the Mayor and approved by the City Council. The Board, in turn, would hire an experienced executive capable of articulating a vision and building support within the community while formulating and executing a successful business plan in Ashland's competitive environment.

The Board and the CEO will be charged with leveraging the unique strategic marketing advantages of this non-profit entity, with decisions regarding programming and services remaining under local control guided by a public service motivation, not shareholder profit. The new non-profit entity will provide an annual report to the Mayor and City Council outlining its performance in achieving its mission and the outlook for years to come.

Unlike the Maintain and Enhance Option, the new non-profit entity could conceivably assume part of the City's $15.5 million obligation based on our estimates of the potential cost reductions it could implement once it was spun-off and still be marginally economically viable. According to Staff, approximately $6.5 million of the total borrowed resulted from subsidies by the City to cover AFN's initial operating losses plus an initial debt payment. Under this scenario, the City would contribute the remaining $9 million in capital assets and construction costs to the new non-profit entity, as well as an estimated $725,000 in cash in the form of a loan to the new non-profit entity for its initial working capital. The City, however, would still be liable for the annual debt service on $9.0 million and on the entire $15.5 million should the new non-profit entity default on its payments.

It is the Committee's opinion that forcing the new entity to immediately assume a debt service obligation would place it under financial stress at a time when it should be focusing on revitalizing its business. The Committee recommends that an assessment be made regarding scheduling of any debt service costs. The potential for assumption of any further additional debt should be addressed in the conditions attached to the formation of the non-profit entity.

In evaluating the Spin-Off option, the City gains numerous benefits, some of which have been previously addressed. These benefits include:

- Separation from the City should provide more focus, passion and specific expertise;
- AFN will be able to operate without either competitive scrutiny or the constant second guessing of certain factions of the citizenry;
- The new CEO will not be saddled with the cumbersome decision process necessitated by City ownership;
- The new CEO will be able to become an effective advocate of AFN's community mission without worrying about potential conflicts of being a public official;
- The new CEO and Board may decide that, upon further analysis, pursuing the Common Carrier Option makes more sense than enhancing products and programming and pursue this change in strategy; and
- As part of the franchise agreement, the City could require the non-profit entity to offer community-specific products and services.

Key negative conclusions include:

- The Committee believes that the success of this venture would be inextricably linked to the success the new CEO has in marshalling community support that will, in turn, lead to an appreciable increase in market share;
- There is no guarantee that the new non-profit entity would be able to be more successful in either gaining additional subscribers or increasing its margins than the City has been, given the fierce competition of Charter as well as AFN's negative public relations history;
- The Committee's projections suggest the new non-profit entity would operate on the slimmest of profit margins, with little margin for error;
- If the non-profit entity is unsuccessful, the City could be forced to repossess the business with the value of the business damaged even further;
- If the new non-profit entity chooses to compete with local ISPs by offering Internet services, indications are that at least one of the seven local ISPs, employing three individuals, may no longer be viable; and
- The City would remain ultimately liable with respect to the entire amount of the $15.5 million bond obligation.

Consequently, while the Spin-Off Option is superior to the Maintain and Enhance Option given the removal of some of the current impediments to effective decision making, it is not without risks. Charter will still remain a tough competitor and AFN will still likely require frequent additional capital expenditures to stay competitive. Key to the success of this new non-profit entity, as noted above, will be the ability of the new CEO to enlist community support and thereby attract both incremental market share and market rates. However, given the past community division over AFN, it is far from clear whether the level of community support needed to ensure the long-term success of this non-profit entity can be achieved.

Sale of AFN

Community considerations notwithstanding, sale of AFN to either Charter or some other party, would result in the most predictable financial outcome for the City overall, even if the result of such a sale would be an increase in every Ashland citizen's current cable rates to market levels and the possibility of reduced competition in the provision of CATV services to Ashland.

To that end, discussions have been initiated on a preliminary basis between Staff and three potential financially qualified buyers in an attempt to ascertain the interest of each party. While we currently do not know whether any or all of these parties would be interested in acquiring AFN, and if so, at what price, we are nonetheless attempting to create a competitive situation among these three most likely buyers. The intended result will be to produce one or more purchase proposals at market or better. On the other hand, there is the possibility that none of these three parties will either have any interest in purchasing AFN or interest at an acceptable price and on acceptable terms. Either way, the Council will have a much better view of its options following receipt of this preliminary feedback.

As part of its assignment, the Committee discussed the theoretical valuation of AFN using data from publicly-held comparables. This analysis suggests that AFN could theoretically be worth as

much as approximately $10 million, using the per-subscriber enterprise valuation of Charter. Utilizing the per subscriber valuations of certain cash flow negative comparable public companies produces a theoretical value of about $5 million.

The valuation will vary significantly depending on a number of factors, including but not limited to: 1) who the buyer is; 2) whether the sale includes both subscribers and assets; and 3) whether only subscribers are sold and all physical assets (including head-end and hybrid fiber coax network) remain with the City. If a sale is to be pursued, these factors will need to be quantified as part of the sale negotiations. Moreover, other variations are also possible. One important element in the determination of value is the fact that the vast majority of cable modem users do not have a billing relationship with the City but are actually customers of the ISPs. It is unclear how many of those customers could be counted in a subscriber sale nor how much of the wholesale revenue stream would remain once AFN is not a community-owned asset.

Thus, the key reasons for pursuing the sale are as follows:

- A competitive selling process, as opposed to a forced sale, maximizes value thereby reducing the debt as much as possible;
- The City can still pursue other alternatives if the sale is unable to be consummated at an acceptable price;
- Uncertainty as to AFN's future is eliminated if a sale is consummated;
- The time and financial drain on City, the Council, Staff and the community will be eliminated once and for all if the asset is sold;
- A franchise agreement could be written to protect community interests.
- The buyer may have the financial resources to pursue the introduction of new services in a more timely fashion than the city.

Key risks associated with the sale of AFN include:

- Risk of rapid deterioration of customer base (and valuation) if sale process is drawn out;
- Possible negative impact on employee morale;
- The City will likely be unable to recover some or most of the debt if AFN is sold;
- There is the possibility that the City will not generate either any interest in AFN or interest at an unacceptable price, further tarnishing its ultimate marketability and forcing it to pursue the Spin-Off option; and
- The buyer may gain sufficient control over Ashland's market to reduce competition significantly and may increase rates, decrease services, exert control over content, and delay introduction of new services.

The present and near-term markets for television and Internet services are sufficiently competitive (see Appendix C) that, if this were a static situation, further risk to taxpayer dollars should be eliminated, recovering as much of the debt as possible. However, future technology and business changes may eliminate the present competitive market, leading to a monopoly which, once again, would need taxpayer dollars to provide reasonable rates, content, and service.

KEY RECOMMENDATIONS

The Committee strongly recommends that the City Council pursue the following courses of action. In particular, the Committee believes the City Council should direct the staff to present the City Council with its legal and financial findings with regard to the following options no later than January 15, 2006, so that a decision to pursue one of the following courses of action can be followed with due haste.

1. Pursue on an expedited basis the sale of AFN to one of the three entities with which Staff is currently holding discussions. The objective of these discussions should be to elicit a non-binding letter of intent. Bidders should include the following in their indication of interest: a) proposed purchase price range; b) required due diligence necessary to firm up their bid; c) estimated time range to complete such due diligence; d) any contingencies that might affect their proposal. Staff should contact each bidder to ask that these non-binding indications of interest be received no later than December 15, 2005. Staff should provide each bidder with any basic information necessary for such bidder to submit its indication of interest. Once these indications are received, Staff and the Committee can clarify and evaluate the letters and make appropriate recommendations to City Council;

2. Contact three or more qualified investment banking firms specializing in the sale of CATV/Internet systems similar in size and scope to AFN. The purpose of this exercise is to: a) solicit input on the salability of AFN to third parties and, perhaps more importantly, the likely proceeds to be received; b) to understand the length of time required to complete such a process if undertaken; c) to understand the costs involved in completing such a process; and d) to exert additional pressure on the three parties above to consummate the transaction; and

3. At the same time the Council pursues the two recommendations above the City should simultaneously pursue the Spin-Off option, initially by having counsel analyze various options, and ultimately by putting in place all necessary measures so that, should AFN not be sold, the City Council is in a position to move quickly to pursue this option with a minimum of delay, but in no event later than January 15, 2006.

AFN Spin-Off
Concepts

Attachment III

Terms between City and Spin-Off

1) Duties
   a) Spin-Off to use best efforts to ensure provision of state of the a telecommunication services within the City of Ashland; such se without limitation:
      i) Data
      ii) Video
      iii) Voice
   b) State of the art to include all telecommunication services, in both type and performance, common to the San Francisco Bay Area and Portland Metro Area excepting those whose value depends upon broad geographic coverage, e.g. cell phone service.
   c) Spin-Off is neither encouraged nor discouraged to provide services outside of the City Limits; it is expressly permitted to do so
   d) Should Spin-Off determine that it is in its best interests to provide services whose value depends upon broad geographic coverage, whether directly or by remarketing agreements, it is expressly permitted to do so
   e) To the extent feasible, as determined by Spin-Off, services shall be provided through competitive arrangements; this means that Spin-Off shall seek to limit its activities to the ownership and maintenance of the distribution network and ancillary activities and shall encourage multiple service providers to use that distribution network to provide services
   f) Spin-Off responsible for all customer interactions, including
      i) installation and billing
      ii) deciding whether to maintain or terminate current customer and vendor relationships including current ISP and cable TV contracts
2) Capital Assets
   a) Current capital assets include distribution network, head end, and set top boxes; all assets not specifically listed are excluded meaning City continues to own and manage them unless other specific agreements are made
   b) Ownership of current assets retained by City
   c) Additions and replacements owned by Spin-Off; this includes, without limitation, any wireless or fiber to the home additions
   d) Spin-Off responsible for maintenance of all capital assets
   e) Any residual value of replaced equipment credited to City
   f) Any assets currently owned by the City plus any capital assets within City Limits, whether current, additions, or replacements, revert to City upon termination
   g) Any assets added by Spin-Off outside City Limits remain the property of Spin-Off upon termination
   h) Spin-Off may move the head end at its option and cost at any time; if moved outside City Limits then what happens on termination?

i) Spin-Off to make services available throughout the City Limits within the limitations imposed in paragraph "Operating Funds" and consistent with stated customer need and sound business practices

3) Debt
   a) All current debt obligations remain with the City
4) Operating Funds
   a) Spin-Off must use excess of revenue collected within City Limits over expenses incurred within City Limits to (in order)
      i) Ensure operating reserve requirements are met
      ii) Pay 50% of such excess to City in recognition of use of City's capital assets
      iii) Build capital improvement reserve (amount determined by Board)
      iv) Provide for employee incentive payments
         (1) CEO bonus
         (2) Other employee bonuses
   b) Once the aforementioned uses of excess revenue over expenses within the City Limits have been met Spin-Off shall either
      i) Reduce service rates, or
      ii) Return the excess to the City by cash payment
   c) City to provide initial operating reserve and capital improvement cash
   d) Spin-Off to provide all reasonable insurance, including, but not limited to, director's liability insurance
5) Board
   a) Initial board size to be a minimum of 5 members
   b) Initial membership appointed by mayor with consent of council
   c) Upon expiration of term board appoints new members with consent of mayor and Council
   d) Board may increase its size, at its discretion, to any odd number
   e) 3 year terms
   f) Staggered terms, as nearly as practical 1/3 of membership expires each year
   g) Responsible for articles of incorporation and bylaws; no changes to them may conflict with these terms without consent of mayor and council
   h) Board hires / fires CEO
6) CEO
   a) Hires / fires all other employees
   b) Has all other powers of corporation not expressly reserved to Board
7) Transferability
   a) Spin-Off may not transfer or assign the capital assets or duties contemplated by this agreement without written consent from the City
8) Audit
   a) Spin-Off shall maintain records of capital and operating revenues and expenses sufficient to establish faithful execution of this agreement
   b) Once per year Spin-Off shall make available to City a summary financial report establishing its compliance with this agreement
   c) City may, at its own expense, hire a neutral 3rd party auditor to examine the detailed private records of Spin-Off to verify the yearly summary financial report
9) Termination

a) City has right but not obligation to terminate agreement when any of the following conditions are met
   i) Material breach of contract by Spin-Off
   ii) Spin-Off insolvency
   iii) Operating reserves fall below xx% of expenses; how much?
   iv) City and Spin-Off jointly agree to terminate agreement
   v) 20 years from inception unless extension agreed upon by City and Spin-Off

10) Other
   a) Space for head end, office, and sat. dishes leased by spin off at rates set by market for similar space in Ashland
   b) AFN name belongs to Spin-Off
   c) Spin-Off to make offer or not for rolling stock within 6 months of incorporation
   d) City to pay standard rates, as set by Spin-Off, for services provided to City

JPR Foundation, Inc.

1250 Siskiyou Blvd. · Ashland, OR 97520 · 541-552-6301

December 20, 2005

Mr. Gino Grimaldi, City Administrator
City of Ashland
Ashland OR

Dear Gino,

The JPR Foundation wishes to express to the City, in response to the City's invitation at the Council's November 29 Study Session, its interest in assuming responsibility for the Ashland Fiber Network.

As you are aware the Foundation has, through its JEFFNET subsidiary, been involved as a partner in AFN's operation since the network's inception. We step forward at this point because we believe the Fiber Network is an important civic resource and because we believe our experience in the not-for-profit communications world would enable us to both effectively operate AFN and to do so in a fiscally responsible manner. Our goals, therefore, are to assure that::

- Ownership and control over AFN remains with a not-for-profit entity
- Ownership and control over AFN remains locally vested
- The relationship of the participating local ISPs with AFN continues
- The City achieves a reliable and secure financial posture with respect to AFN.

We wish to acknowledge, and express our appreciation for, the support we have received over the past several weeks from City staff who have been prompt and generous in providing us information necessary for us to understand of AFN's current operations in order that we could evaluate our own capabilities for assuming responsibility for AFN. That said, neither the City nor we have had sufficient time in which it is possible for us to formulate a fully detailed proposal. Assuming the City wishes to continue this discussion with us, with the goal of developing a draft agreement, we would mutually work to further define those areas which require additional information/consultation in order that a fully specific proposal can be crafhed.

With respect to major elements of this expression of intent, however, we advance the following basic components. The JPR Foundation would:

- Assume full responsibility for the system's operation as of a mutually agreed upon date
- Annually return to the City a sum, currently estimated to exceed the $326,000 figure postulated in the AFN Options Committee's "spin off" *pro forma*. This sum would be

payable for the period of the City's bonded indebtedness for the AFN system (which we understand to be twenty years) and would constitute our payment for the exclusive rights, ownerships and other consideration transferred by the City to the Foundation

- Operate the Internet portion of AFN under the current "open access" model thereby enabling the existing ISPs on the system to continue their operations

I would note that this Letter of Intent is crafted for the purpose of expressing our intentions based upon our current understanding of AFN's operations. Our subsequent execution of a specific agreement with the City would be subject to approval by the JPR Foundation Board of Directors.

Sincerely,

Ronald Kramer
Executive Director

JPR Foundation (JPRF) – City of Ashland (City)
Draft Conceptual Agreement

1. JPRF would lease the use of the Ashland Fiber Network for a period of 20 years for the purpose of providing cable television and internet services. JPRF and the city recognize the need for a long term lease that could not be terminated by either party during the term of the lease.

2. An initial base lease amount would be negotiated. A mechanism for increasing the base should JPRF expand the use of the system to provide new services would be negotiated.

3. JPRF would lease from the city physical space needed for the head end equipment, satellite equipment and office space that may be needed by JPRF staff.

4. JPRF would purchase the head end equipment, satellite equipment, and set top boxes. City would be willing to sell AFN vehicles. The City would be willing to allow the purchase of the equipment to take place over several years.

5. JPRF would have the right to use the Ashland Fiber Network name and logo during the term of the lease agreement.

6. JPRF be responsible for the maintenance and system upgrades of the network. Performance criteria for the maintenance and upgrades of the network would be established and reviewed every 5 years. The goal would be to maintain state of the art telecommunication services in the city of Ashland for services including, but not limited to data, video and voice

7. JPRF would be responsible for expansion of the network. Decisions regarding the expansion of the network would be made exclusively by JPRF. JPRF would not be encouraged or discouraged from providing services outside of the city limits; it would be expressly permitted to do so.

8. Assets purchased and installed by JPRF that cannot be removed without compromising the functionality of the network, would become assets of the city

9. JPRF would be responsible for providing appropriate infrastructure to provide cable and internet services to new homes and businesses within the city of Ashland.

10. JPRF would be required to obtain a franchise agreement with the city of Ashland.

11. The city of Ashland would be allowed to use the network for activities related to the operations of the city of Ashland. The city would pay for the use of network. Current uses of the system would be allowed by JPRF. The city anticipates but cannot identify future uses of the network. Future uses of the system would be allowed by JPRF provided that the city use does not have a negative impact on services being provided by

JPRF and subject to successful negotiation of a contract for services between JPRF and the city.

12. JPRF would be responsible for all billing and accounting regarding the operation of the network. The city would be willing to sell billing and accounting services to JPRF during a limited transition period.

13. JPRF would continue to provide service to existing ISP's and would not be required to provide service to additional ISP's.

Open Carrier (formerly Common Carrier)

Executive summary

Given that the AFN Internet service currently makes the city money while providing an increasingly essential service, retaining Internet service is critical. As it is currently designed, AFN Cable TV service loses money and thus is less of a priority at this time. The Open Carrier model is designed to provide Internet service and base-level (local only) television service to all residents in town. The model is designed for partners and/or third parties to provide expanded TV options.

Since the AFN infrastructure would remain under City management, other services, in addition to expanded TV service can be provided by third-parties on the Open Carrier. ISPs will continue to provide email, security, technical support, and other services over the network.

The range of options under the Open Carrier model allows the City to pay some portion, possibly all, of the AFN debt. In this alternative, everyone pays something towards the system, and everyone gets base-level Internet access and base-level TV from the system. A low-income exception is provided.

Key Concept

A viable option would be for the city to maintain internet connections to our residents and businesses as an open system where we would encourage other services to share our network. Since the city would not control content and would welcome access to other businesses providing competing services, we have taken the terms" Common Carrier" and "Open System" to create this "Open Carrier Model." Under the Open Carrier, current AFN customers will be able to keep their current service with their ISP. Without the burden of TV, current customers may even pay less overall than without the plan.

The design and implementation of AFN presumed that broadband fiber would not only provide Internet and cable television service (two distinctly different businesses), but that it would serve as a delivery mechanism for services that had not yet been invented. While there is uncertainty in both businesses, there is a growing body of literature that confirms future demand for highspeed fiber.

We do not know the future form of Internet delivery, but we do know that it is becoming evermore critical to our day-to-day lives and that the number of people accessing it is growing. The demand for bandwidth is growing and the cost is dropping. Like electricity, there will be new appliances built to utilize this service once it reliably reaches everyone at a reasonable cost.

However, the cable television business is in turmoil. Service and programming costs are rising faster than the cost of living. The money and expertise needed to manage capital investment demands are intense; the advent of high definition television is a recent example of the need to upgrade and replace equipment on a regular basis to stay competitive. Customer dissatisfaction with the value received for increased rates is growing. The industry will change in

response to this; unbundling packages is one response; there will be others. This is the business that requires a nimble management to survive.

The city structure is well suited to operating the Internet service, and has done so. There is every reason to expect that the City's reliance on this service for its operations in every department will increase; retaining the ability to utilize it for new applications without additional leasing expenses is fiscally prudent. While operating the system under this proposed model will reduce the need to modify administrative procedures that provide effective oversight while allowing flexibility, we believe that considering modifications will benefit the City. The service can be grown and improved under skilled leadership, given sufficient authority, responsibility, and resources.

This model recognizes the difficulty and risk in operating cable television service in the current market and technology. The city structure is not well suited to this business. However, the model supports the provision of TV service, including community television to residents, through agreements with third parties. A satellite provider may be a good way to our extend basic local service to the latest technology.

Goals

1. Provide the widest possible bandwidth at the least possible cost to all residents and businesses in Ashland.
2. Provide a base level of Internet and TV service to all who must pay a fee.
3. Do not overburden low-income households.
4. Support technical innovation and competition for services in Ashland.
5. Retain local ISPs' role as primary customer service providers.
6. Seek a partner to provide TV service on our network (A local partner is desirable).
7. Pay off as much of the debt as practical.

Implementation Overlook

There is a continuum of options for the structuring and the financing of the Open Carrier model. We will explore some of the ideas and identify variables in the model that can be modified for the desired result. All options presume an "Everyone pays something; everyone gets something" assumption. The figures below will help to visualize our options.

We began our exploration by looking at <u>one endpoint</u> on the continuum. We analyzed the monthly cost per household of providing Internet service (using a conservative projected cost of service), added the debt payments, and assume no revenue from either the base level service or from leased use of broadband for other services. It is the simplest scenario to model and defines a maximum fee cap to households; the base cost of the service is equal to the maximum fee cap. That results in an option with dependable, guaranteed funding with no "rosy projections" and no surprises.

It was necessary to make some basic assumptions for comparing a range of options:

- 1000 customers unreachable initially

- 1000 low-income customers exempted from paying
- Approximately 7000 residences and 1000 businesses are fee payers
- Annual cost of running the operation projected at $900K
- Annual debt payment projected at $1.4M.

The first decision point and variable is what amount of the current debt is to be assumed by Open Carrier. This will vary from none to $15.5M and will directly affect the maximum fee cap. A second decision/variable will be whether to charge more for business users than for residents. For instance, the business base fee and fee cap could be twice the residential fees. Businesses benefit more; economic development is furthered.

Next, we look at restoring a revenue stream from the service to the operation. "Everyone pays something; everyone gets something. Those who pay more get more." In this model, everyone gets a base level service that may be slower than our current modem service (yet still 5-10 times faster than dialup). For additional fees to ISPs, customers can receive regular or higher level modem service. This service level could reduce the base fee considerably, but not reduce the cap fee. Other revenues would be from high speed or high volume users such as SOU or Internet Businesses. Access fees may be charged to businesses offering new services on our network.

This second model could be refined by using "revenue feedback". The base level fee would be adjusted each year based on the previous years profit or loss. A profit reduces the base level fee or adds to the levels of service. A loss increases the base fee, but has the protection of the fee cap. Maintenance and expansions must be within budget.

Our model incorporates the task of completing the network within the first two years' budget, which will expand the base of customers and reduce the base fee. This activity may not require additional significant debt.

Figures

In the table below, the percent of debt assumed by open carrier is across the top, and the percent of current revenue fed back into the system is down the side. It is expected that, initially, revenues will drop as some users "downgrade" to the base level service, but could well rise over time as:

- More users join the system with the build-out and as growth occurs
- Users "upgrade" to higher bandwidths
- More High-Speed businesses are added
- Partners and third parties pay fees to provide additional services

Residential Payment Per Month – Year 1

		% of Debt Assumed by Open Carrier				
		0%	25%	50%	75%	100%
% of Current &	0%	8.33	10.19	12.04	13.89	15.74
Prospective	50%	1.62	3.47	**5.32**	**7.18**	**9.03**
Revenue Retained	100%	0	0	0	0.46	2.31
by Open Carrier	150%	0	0	0	0	0

Assumes:
7000 residential, 1000 business customers
Business multiplier of 2
Debt payments of $800,000

Residential Payment Per Month – Subsequent Years

		% of Debt assumed by Open Carrier				
		0%	25%	50%	75%	100%
% of Current &	0%	7.21	9.82	12.42	15.02	17.63
Prospective	50%	1.40	4.01	**6.61**	**9.21**	**11.82**
Revenue Retained	100%	0	0	0.80	3.41	6.01
By Open Carrier	150%	0	0	0	0	0.20

Assumes:
8000 residential, 1200 business customers
Business multiplier of 2
Debt payments of $1,300,000/year

ADDENDUM: These charts need modification to show that debt payment is $1.4 M and fees would not be reduced in the first two years in order to pay build-out costs.

Future Concerns

If the decision of the City Council is to choose the Open Carrier Model, it will, at some point, need to make decisions about a number of considerations we have identified (below). Additional options and opportunities with this model seem to surface with each discussion. The IT Director and a Technical Steering Committee would be required to flesh out these ideas and build a transition plan. We are convinced that this direction is sound and are confident that it is the best direction to take on behalf of our residents.

1. What portion of debt should be assigned to Open Carrier? $5M-$8M?
2. What's the best way to finance the remainder of the debt? Assets?
3. What is the technology and cost for the build-out? Did we a allot enough?
4. In what form are the fees? Utility bill? Property tax?
5. Trim conservative budget to reality.
6. More accurately assess the real numbers of customer categories? Unreached1000/Low-income1000/Residential7000/Business1200?
7. What is the multiplier for business? 2? 3?
8. What is the base level of internet service? Down/Up?
9. Find a TV partner, form/foster a TV coop, spin-off TV or sell customers? Ask current TV customers their preference?
10. Determine internet service tiers and cost/price.
11. What channels can be included in the base level TV service?
12. Will ISPs gain or lose customers? They supply Email, Tech Support, Security...
13. Some customers will not require an ISP. There will be no tech support as part of the City's base level service to residents.
14. Which direction should the money flow? From Customer-to-ISP–to-City (as is done now) or some other way?
15. Automate sign-up registration and option changes?
16. Transition to much higher bandwidths.
17. How to handle high-speed customers? City or ISP? It is a city priority.
18. Who owns or controls the fiber to Medford? What restrictions exist for its use?
19. How will Open Carrier be marketed/communicated to current and new residents and businesses?

Open Carrier Need Statement

It is important that Ashland be positioned with the resources, infrastructure, and the social capabilities that will empower its diverse set of citizens to be economically and socially vibrant. In order to do that, it is necessary to understand as much as possible about the trends that will exert primary influence on the future. One of those trends is the essential role technology plays in our economy and in everyday life.

The excerpts at the end of this section are from an article titled "Living in the U.S.A. 2000-2020" by David Pearce Snyder (© 2005) that offers predictions about the role that technology will play in our near-term future. The excerpts are a sample of the kind of information needed to set the context for discussions about the future of AFN.

The trends point to the importance of maintaining control over the new "I-way." The use of Internet access is no longer confined to entertainment or data manipulation. Ashland's high rate of home-based businesses, its elderly and student population, and a concentration of expertise in technology make it especially well-positioned to benefit from the AFN infrastructure we invested in. Under the Open Carrier Model, the city maintains decision making power and can ensure equal and city-wide access to AFN. It also controls the cost of the City using AFN services. Control over this resource will allow the City to more directly influence key, city-specific issues like high-paying, environmentally-friendly jobs, long-term economic development, affordable housing, etc.

As is indicated below, a resident's current use of AFN services is not an adequate measure of its current or potential value to them. One parallel is the upgrading of the City's Wastewater Treatment Plant. While we could have accomplished our initial goals with an investment of $12 - 20 million, OR Dept. of Environmental Quality increased the standard for Ashland. The debt for the upgrade, including the additional millions of dollars needed to meet the standard Ashland was held to, is being paid for by taxpayers and through the local meals tax. The silver lining is that we produce treated water that can be used for irrigation; we are close to being able to produce water that we could drink if circumstances required it. We are well-positioned for the future.

Had Ashland not invested in AFN, it is quite possible that most residents and businesses in both Ashland and Medford would have only recently moved off of using dialup Internet access and would be paying considerably higher rates to access a standard tool in the commercial, medical, entertainment, and financial worlds. The social contract for living in a local, state or national context is to share responsibility for the whole.

Criticism has been leveled against AFN that government can't run businesses and that AFN has suffered from confusion over whether it's a utility or a business. The Open Carrier alternative responds to that critique by maintaining public control of operations and revenue of the backbone or delivery system in a manner that facilitates the commercial sector using it to provide additional services. The lessons learned about how operating in public constrained AFN are important for their potential to help us refine government procedures.

The Open Carrier model specifically benefits from:

- The hiring of an AFN/IT Director;
- The lessons learned through having local government operating commercial television
- A deeper understanding of how contract administration could be modified to increase flexibility while maintaining oversight function;
- The reduction of decisions that need to be made in ways that allows AFN to be competitive;
- Increases in market competition for applications using broadband and unbundling (especially television).

Excerpts from "Living in the U.S.A. 2000-2020"

"Historically, a broad rise in general prosperity is one of the *last* major effects of a **techno-economic revolution** – typically following by a generation the oligopolistic concentration of wealth and income that characteristically accompanies the initial introduction of newly-matured technology. Eventually, any free-market, capitalist economy can be expected to fully realize the productive potential of a new technology .... Until this happens, however roughly two-thirds of all U.S. workers will earn less than a median wage, while income distribution will be more concentrated than it has been for 70 years, and wealth more concentrated than it has been since the late 19th century." (pg 6)

"[Information technology} is already having instrumental impacts on the principal components of human enterprise – economic production and distribution, commercial transactions, health, education, and leisure, etc. From now on, IT will have transformational effects on everything we do, in America and around the world." (page 8)

"Meanwhile, 60% of all **U.S. households** are currently online, up from 43% in 2001. By 2010, 70% to 75% of households will be online."

- "Telecommunications experts agree that, by 2010, 80%-90% of all Internet access will be from mobile wireless devices, including laptop computers, Webphones, and PDAs." "Most Americans, however, reluctant to place their vital personal records in the hands of on-line service providers will retain a home computer with a massive memory..."
- "A multitude of telecom distribution media ...will remain simultaneously competitive well into the 21st Century." (pgs 8-9)
- "Discretionary time spent online has increased dramatically over the past 36 months..." (pg 18)
- "Local communities will have professional teams of (electronic) gamers as they now have sports teams." (pg 19)

"The **elderly population** (over 85) is currently increasing at the rate of 50% per decade… About 40% of these people live alone, and they will be more and more dependent on their families *and their IT appliances* for social contacts and domestic support, including finances, entertainment, living assistance, health monitoring and increasingly, the delivery of medical care." (pg 12)

- "By 2020, one-third of all U.S. households are likely to include at least one elderly relative."
- "The aging of the population will increase consumer demands for home based medical care, including electronic health monitoring and diagnostics (especially for millions of solitary seniors), at the same time that medical cost-containment efforts by government will promote home care as the most effective means of delivering health services in America." (pg 18)

"The growth of self-employment, plus the increasing adoption of 'flex-place' arrangements for salaried work will combine to shift **20% to 25% of all gainful employment into the home by 2015**."

- "… the slow growth of the labor pool will force employers to hire most adults – including parents of minor children, caregivers of dependent relatives and millions of home-bound disabled adults, all of which will increase the socio-economic utility of home-based employment."
- "Between 2005 and 2008, state and local governments will begin using special fees and tax incentives to encourage both employers and employees to adopt "flex-place" work arrangements – telecommuting
- …Full time telecommuters will make up 10% of the white collar workforce by 2012, up from 1%-2% today."
- "'Info-preneurships' – eg. Self-employed and sole-proprietor producers of contract information product and services – who are largely home-based - …will rise from 9% of all U.S. workers in 2000, to 15% or 16% of all workers by 2015. (pgs 13-14) "…home-based businesses and flex-based employment arrangements will foster consumer demands for sophisticated IT support for the home." (pg 18)
- By 2008, essentially all job search, application, screening and recruitment will be done online. (pg 18)

Russ Silbiger

From: Russ Silbiger [russ@mind.net]
Sent: Tuesday, March 07, 2006 5:38 PM
To: 'David Chapman'; 'Cate Hartzell'; 'Russ Silbiger'; 'Lenny Neimark'; Paul Collins; alan@opendoor.com
Subject: Basic Model

These are the model numbers I would like to use tonight. Basically this covers the debt.

Monthly Utility Charge: Basic Internet and TV $10.00 residential $20 commercial Revenue = $1,248,000. (8000 x 10 x 12, 1200 x 20 x12) Even reducing by 10% for whatever , we still get 1.12 million.

Full Speed Internet (to ISP) $16 residential $32 commercial Revenue = $840,000 (4000 x 16 x 12, 200 x 30 x 12) 10% error = $756,000

Data Services = $200,000. Total System Revenue = $1,040,000 Total Utility Charge Revenue $1,248,000. Total Revenue $2,288,000

Operational/ Capital Expenses
06/07 $930,000. Debt $1,000,000 = $1,930,000

Surplus to carry forward $358,000 10% error = $150,000

07/08 Rev. $1,248,000 + $900,000 + $200,000 = $2,348,000 Exp $976,000 + $1,200,000 = 1,976,000
08/09 Rev. $1,248,000 + $945,000 + $200,000 = $2,392,000 Exp $1,024,000 $1,420,000 = $2,464,000

(There nay be another year before the debt hits the 1.4 million, I lost my sheet.)