Macquarie Capital

UTOPIA PPP Project

Date	May 19, 2014
To	Lindon City Council
CC	Adam Cowie, City Administrator
Subject	Responses to Lindon's Questions on the Milestone One Proposal

Dear Councilmembers,

Please see our responses to Lindon's questions submitted by email on May 16 below in italics, along with the original questions. These responses should be read in conjunction with our responses to Centerville's questions of May 12, which we understand have been distributed via Adam Cowie. Please note that our responses reflect current "work in progress" thinking and are subject to change as we continue our diligence.

Best regards,

Macquarie Capital

Questions 1-3 refer to operations of the existing network in the event that Cities choose not to proceed with the PDA milestones.

1) Assuming enough addresses are available for Macquarie to take over the network operations, in Cities that choose not to move forward with a utility fee will Macquarie (or other wholesaler) be assessing increased user fees or other charges to the end users – or to the Cities themselves in order to continue providing services to current subscribers?

   The PPP will operate the UTOPIA / UIA network as a single, integrated network. If a City withdraws from the network buildout, we will continue to operate and maintain the infrastructure in that City to allow all users currently active on the network to remain connected.

   The Utility Fee will reflect the integration of the network and as such the remaining Cities will have the right to charge the non-participating City for the ongoing provision of operating services to those users. The size of these fees will be determined by UTOPIA on the basis of parity and not by Macquarie.

2) Will existing lump sum, lease and/or monthly payment options for new hookups still be available?

   The PPP will provide a last mile connection to all premises in the participating Cities. The cost of building this infrastructure will be fully funded and will eliminate the need for users to pay the connection fee currently charged by UIA.

   The PPP will guarantee the cost and date of network completion and as such must have certainty on the number of addresses that are to receive connections at financial close. Thus there will not be an option for users in a non-participating City to request a new hookup during the 30 month rollout.

   The Agencies may seek to explore a mechanism under which Cities can be incorporated into the network at a later date, however this would need to be on a citywide basis rather than a *minority of users. Macquarie has not discussed this mechanism in detail with the Agencies or the Cities.*

3) We understand that no profit sharing from upselling will be available to non-participating Cities since no base service will be offered in those locations. However, there will still be revenues generated from existing connections. Will there be opportunity for revenues from those non-participating Cities to be transferred back to the Agencies? Or will all of the revenues from non-participating Cities go only to Macquarie or the Wholesaler since you'll be operating the network?

   The flow of revenues generated by existing users depends on their classification as UTOPIA or UIA and, in the case of Brigham City, SAA users.

   Existing users on the UTOPIA network will generate transport fee revenue that is paid by the ISPs to the Wholesaler. This revenue will be part of the total pool available for sharing between UTOPIA, the PPP and the Wholesaler.

   Macquarie's working assumption is that the UIA and SAA indentures give bondholders first claim to network revenues generated from existing users on these networks. Macquarie is working with the Agencies and their advisors to develop a proposal for the bondholders that could allow these users to be incorporated into the Utility Fee model, in which case upsell revenue would flow to the Wholesaler and thus be available to UTOPIA through the sharing mechanism.

   Whether non-participating Cities would participate in upsell revenues, for example generated from users within those Cities, will be a matter for UTOPIA to determine.

4) A large assumption is being made that the current ISPs will have the capital and ability to provide the basic level of service and installs to the properties. Has any assessment of the ISPs business model or financial capabilities occurred, or will such an assessment occur in the future in order for ISPs to be able to operate on the network?

   We have maintained an active dialogue with the ISPs through Milestone One and development of the business model to ensure that our proposal is consistent with what the ISPs can deliver.

   The ISPs have consistently stated that they have the resources necessary to provide the basic service. The ubiquitous buildout significantly increases the number of addresses to which the ISPs can market premium products, and providing the basic service should reduce ISPs' overall customer acquisition cost and create more opportunities for targeted marketing to those users.

   The PPP will provide a framework for what is considered a standard installation. These installations will be basic, connecting the network portal to a single internal point, such as a family room. The PPP will rebate the ISPs $50 for every standard installation they complete, which reduces the financial impact and means users will not have to pay an incremental charge. If a user requires a more comprehensive installation, for example wiring multiple rooms, the ISP will have discretion to charge an additional fee. The ISPs will also have discretion in setting those fees, but Macquarie expects competition will result in price discipline.

   Macquarie is drafting a detailed term sheet that will establish the minimum requirements of ISPs to operate on the network. This term sheet, which will form the basis of the service level agreements ("SLAs") for the ISPs, is expected to be more rigorous than current arrangements and will ensure that ISPs have sufficient resources and financial capacity to complete these services.

   Macquarie has also had discussions with new ISPs not currently using the UTOPIA network who have expressed interest in using the network following a ubiquitous buildout.

5) Will the Wholesaler require ISPs to offer a tiered level of services, or will that choice be strictly left up to the ISPs (i.e. 10Mbps, 50Mbps, 100Mbps, 1Gbps, etc.)? Some customers have expressed interest in fiber services, but not interested in paying the price jump from current 10Mbps services to 1Gbps, for example.

   The ISPs will be free to market the products they believe will be most attractive to users in a competitive market. Macquarie expects that the ISPs will continue to market tiered services.

   The Wholesaler's long-term goal is for all users to upgrade to a 1Gbps connection. Gigabit networks have significantly greater functionality than copper- or cable-based networks, and we will continue to actively engage with users through the remaining milestones to ensure that they are fully informed of the products available to them and the benefits of higher speed connections.

6) Is Macquarie interested in outright purchase of the network now or in the future? If not, please explain why?

   The costs and benefits of selling the network relative to a PPP are discussed in Section 2 of the Milestone One proposal. Macquarie is firmly of the belief that the PPP will create significantly greater value for the Cities than a network sale at the current time whether to Macquarie or another party.

   The PPP allows the Cities to transfer substantially all the development, operations, maintenance and technology refresh risks to the PPP over the long term and resume operational control of an established asset with potential to generate over $100 million in annual free cash flow. The PPP also permits the network to be open access, which will promote competition between ISPs and should create value for users both on and off the network.

   Selling the network to Macquarie or another third party would prevent the Cities achieving a number of their objectives. Macquarie would gain full control of the network and would thus be incentivized to pursue a proprietary model similar to Google to capture all the network upside. The network would no longer be open access and users would not receive the benefits of competition. Additionally, the proceeds to the Cities would be based on an adversarial negotiation process rather than a collaborative approach to revenue sharing.

   Macquarie and First Solutions are primarily infrastructure developers. Our core business model is to partner with governments and governmental agencies at the local, state and federal level to ensure efficient delivery of essential infrastructure. Acting as an ISP and providing services on the network is not consistent with this business model.

   Other areas of Macquarie's business could be very interested at a future point in time in buying the network outright. However we do not believe this to be the best model for the Cities to follow.

   The Cities could choose to sell the transport revenue stream which they will receive, either to Macquarie or another party in the future. This would allow the Cities to front end their revenue streams and use the proceeds to repay the existing debt obligations early (to the extent this is economic) or to fund other City projects. This, in our opinion, would be a more effective model for the Cities to follow than the outright sale of the network.

7) Is Macquarie able to provide the minimum number of addresses needed in order for it to proceed with the deal? What is the cutoff point for Macquarie to proceed or not?

   The PPP is intended to be a ubiquitous build in all Cities. If a City withdraws, all users in that City that are not currently connected to the network will be excluded from the PPP. Macquarie's decision to proceed into Milestone Two will thus be determined by the number of Cities that vote to participate in the transaction. Each City has a different number of addresses *and cost to complete, and so the cutoff point will also depend on which Cities vote in favor of the PPP.*

8) Is Macquarie open to having an independent third party review of the P3 proposal in regards to the proposed business plan, finances and proposed technologies? Can the PDA milestone timetables be extended to accommodate such reviews?

Yes, Macquarie is very open to having an independent third party review of the PPP proposal and strongly encourages this.

The PDA already contemplates this and outlines a number of critical workstreams that have been or will be reviewed by independent consultant. For example,

1) Lewis, Young, Robertson and Burningham, Inc., the long time financial advisor to UTOPIA and to many of the Cities, has been engaged to conduct a comprehensive review of the business and financial model. This work will continue in Milestone Two

2) Kirton McConkie, the long time legal counsel to UTOPIA, has been engaged to act for UTOPIA and the Cities on legal issues and this work will also continue in Milestone Two.

3) Macquarie engaged CTC Technology & Energy ("CTC"), a consultant with extensive experience in municipal fiber, to review the feasibility of the proposed business model. A summary of CTC's conclusions is included in Section 3.5 of the Milestone One report.

4) Macquarie has also engaged Arup USA Inc ("Arup") to act as the Lenders' Technical Advisor ("LTA") on the project. The LTA will complete a detailed review of the PPP's technical plan on behalf of the lenders and UTOPIA to ensure that:

- *The technical solution proposed is feasible;*
- *The potential risks of this solution have been identified; and*
- *Appropriate risk mitigation strategies are in place.*

The LTA's conclusions will have a critical role in determining the financing package available to the PPP. If the technical solution proposed is considered relatively risky, the security package required from the PPP will also be relatively high to ensure there is sufficient downside protection.

The contractors involved in this project are also world-class equipment suppliers and contractors with proven technologies. Some of these contractors either are or have previously been suppliers to UTOPIA, and thus we consider the technical risk of the project relatively low.

Macquarie will also engage lenders' counsel to review relevant project contracts on behalf of the lenders. All reports of these independent advisors will be shared with the Agencies under the open book process.

Macquarie believes these advisors, which are all budgeted under the PDA, will provide a comprehensive review of the business plan, finances and proposed technologies. Any additional independent review could also be accommodated within the milestone timetables.

5) We've heard Macquarie state that the Agencies will be hold them to a certain level of service / performance as a Wholesaler and that payment of the Utility Fee will not be required if Macquarie fails to meet that level of service. What about ISP performance standards? Will increased standards be imposed by Macquarie on existing and new ISPs? If so, what types of standards will be necessary and how will those standards ensure adequate performance on the network?

The Concession Agreement between UTOPIA (or a new Interlocal Agency) and the PPP will set out required network performance standards, which will be monitored and regulated by

UTOPIA. There will be a payment deduction regime in relation to performance deficiencies, ultimately leading to UTOPIA's right to terminate the concession.

It is anticipated that the monitoring of performance will also be assisted by the ISPs and end users who will have the right to complain to UTOPIA in the event of network performance issues. For example, a network outage would likely result in (a) a rebate from the ISP to the end customer, (b) a rebate of transport fees payable by the ISP to the Wholesaler or (c) a reduction in the availability payment made from the Utility Fees to the PPP.

The SLAs between the PPP and the ISP, in addition to replicating the network performance standards in the Concession Agreement, will outline in detail the requirements to which the ISPs must adhere to operate on the network. These standards will include minimum customer service requirements and annual disclosures, among others. The SLAs will also include a transparent process for disciplining ISPs that do not meet these requirements including, in the extreme, expulsion from the network.

The detailed regulatory and oversight structure for ISPs and the Wholesaler are being developed as part of the Wholesaler's detailed business plan, which will be shared with the Cities during Milestone Two.