

FREEDOM FOUNDATION OF MINNESOTA

NORTH ST. PAUL OPERATES “UNDER THE RADAR” ON POLARNet

FEBRUARY 2009

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OF MINNESOTA
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On Tuesday, February 24, North St. Paul voters will decide if they want to ante up \$18.5 million to build a citywide telecommunications and high-speed Internet network.

The referendum may have ramifications well beyond the suburb's borders in a number of Minnesota communities that are laying the groundwork for similar telecom and Internet projects.

While no city should be at a digital disadvantage in the information age, the North St. Paul referendum raises a number of concerns that taxpayers should weigh before handing over the remote control to local government.

North St. Paul's government-run fiber-optic system, called "PolarNet," would provide residents with phone, cable TV and high-speed Internet services, all of which are currently available from existing providers. In other words, there are companies in the Yellow Pages that already provide largely the same services! Residents can currently surf the web at home or local library, while the mayor can log onto a high-speed Internet line at city hall.

It seems prudent to consider whether government has any business being in this business, even in rural areas where there's a problem with a lack of high-speed Internet services. A city-by-city approach arguably will only burden existing taxpayers, who can't afford this additional hardship. Now more than ever, cities should focus on providing essential services, rather than risking valuable tax dollars on speculative projects. There is a lot on the line for taxpayers with cities statewide facing record budget shortfalls—a \$750,000 budget deficit in the case of North St. Paul.

To put the financial risk in context, PolarNet's price tag is three times the city's annual budget, or \$4,000 for each of North St. Paul's 4,700 households. In fact, while PolarNet is billed as an \$18.5 million project, city taxpayers will actually pay out closer to \$35 million over the life of the bond when interest is included.

Simply stated, PolarNet's success hinges on the city's ability to convince a huge number of residents to cancel their existing services with their private provider and sign up for a government-run enterprise. Should PolarNet fail to attract enough customers, every single city taxpayer is on the hook. If the performance of other government-run networks across Minnesota is any indication, North St. Paul residents should be very concerned that PolarNet

may leave them PolarFleeced.

St. Louis Park has abandoned its solar-powered "green" wi-fi network following a string of technical problems, legal battles, and complaints from residents. Minneapolis' foray into citywide wi-fi has also been a costly mess. While Minneapolis pays well over \$1 million to use wireless, only about \$50,000 of services will be used this year, according to MPR. Everything beyond that \$50,000 will be subsidized by the taxpayers.

Meanwhile, Moorhead taxpayers have been hit with double digit electric rate increases to subsidize the city's "GoMoorhead" broadband service. While projecting 4,000 customers by 2006, as of late 2008, the service had just 2,800 subscribers, not nearly enough to even break even.

Yet, nowhere on North St. Paul's website or in their publicly distributed materials do officials acknowledge the true extent of risk to taxpayers, revealing a troubling lack of transparency in the process leading up to the February 24th referendum. In several memos and e-mails obtained through public records requests, top city officials and paid consultants discuss withholding key information from the public about PolarNet's risks, costs, and viability.

Documents show that city leaders intentionally kept PolarNet "under the radar" and out of public view. There was discussion of withholding from "anybody, including the Council, and definitely the public," information about the expected rates residents will pay for PolarNet services.

They strategized ways to make documents "hard to decipher" and "nearly unusable" for a public records request. The City Manager explored strategies to build PolarNet without even allowing residents to vote.

The city council held two off-the-record "workshops" to discuss final plans for PolarNet. No minutes or video of these meetings have been made available, arguably in violation of the spirit, if not the letter, of the open meeting law.

North St. Paul leaders are asking voters to trust them on a proposal that one memo says "means more to [North St. Paul's] future than any other single project." In the project's planning stages, however, it's almost as if the city treated PolarNet a matter of classified cyber security and their

own residents as security risks.

While it won't be on the ballot on Tuesday, the special election in North St. Paul may hinge on questions of open government and transparency, in addition to whether PolarNet poses more risk than reward to taxpayers.

SOURCES

¹ Memo from City Manager Wally Wysopal to Mayor and City Council. "Subject: Fiber Project Update." January 28, 2008

² E-mail from CCG consultant Doug Dawson to City Manager Wally Wysopal. "Subject: NCTC Coop membership." January 6, 2009.

³ E-mail from CCG consultant Doug Dawson to City Manager Wally Wysopal. "Subject: Re: Qwest data request." December 23, 2008.

⁴ E-mail from CCG consultant Doug Dawson to North St. Paul staff member Nate Ehalt. "Subject: Re: Fiber Question." November 10, 2008.

⁵ E-mail from Springsted consultant Terri Heaton to City Manager Wally Wysopal. "Subject: Broadband bonds." September 30, 2008.


⁶ E-mail from CCG consultant Doug Dawson to City Manager Wally Wysopal. "Subject: Revised financial models." March 10, 2008.

⁷ E-mail from CCG consultant Doug Dawson to Milda Hedblom, Joel Jamnik, City Manager Wally Wysopal, and NSP staff member Nate Ehalt. "Subject: Re: Invite letter from the City of North St. Paul." December 5, 2008.

⁸ E-mail from consultant Doug Dawson to City Manager Wally Wysopal. "Subject: Re: HBC." June 23, 2008.

⁹ E-mail from CCG consultant Doug Dawson to City Manager Wally Wysopal. "Subject: Re: Alternate Financing." December 10, 2008.

MEMORANDUM
CITY OF NORTH ST. PAUL

TO: HONORABLE MAYOR SANDBERG AND CITY COUNCIL MEMBERS
FROM: WALLY WYSOPAL, CITY MANAGER 
DATE: JANUARY 28, 2008
SUBJECT: FIBER PROJECT UPDATE

In the weeks and months ahead the staff and council will be working to develop and finalize a model for its fiber project. This model will serve as a business plan and will include goals, objectives, outcomes, as well as be a financial blueprint for public accountability purposes. As a primer for that discussion, enclosed is a policy brief produced by the Institute for Local Self Reliance (ISLSR). The ISLSR is a non-profit research and educational organization that provides technical assistance and information to city and state governments, citizen organizations and industry. This policy brief entitled *Municipal Broadband: Demystifying Wireless and Fiber-Optic Options* provides excellent historical background and places the questions we will be addressing in its proper context.

To date, our project has been kept well under the "public radar." This has allowed us to do a tremendous amount of footwork and develop a certain level of expertise in the subject area. To date, a team of experts has been assembled to assist staff in the development of the North St. Paul fiber model, which includes the City of Roseville's IT Department, C.C.G. Consulting, Briggs and Morgan attorney at law, Springsted Incorporated, and Access Communications.

We are anticipating a February 19th workshop on the subject matter and encourage review of the attached policy brief prior to that time. This will begin the process of unfolding the project to the public.

The staff is absolutely convinced that this fiber project means more to the City's future than any other single project including the redevelopment of Highway 36. We appreciate the City Council's support and patience as this project has progressed and we look forward to the future that this technology will bring.

Wally Wysopal

From: [REDACTED]
Sent: Tuesday, January 06, 2009 8:40 AM
To: Wally Wysopal
Cc: [REDACTED]
Subject: NCTC Coop membership

Wally:

NCTC finally posted their first form yesterday. This is no an application form, but rather a pre-application form to see if we qualify to make an application. Here is the form:

<http://www.cabletvcoop.org/docs/QualificationQuestionnaire.pdf>

There are two problematical questions on the form that we want to consider before we send this in.

The first troubling question is item 1 that asks if we are a cable system under 47 U.S.C. Section 522(7). While this doesn't say it, I've gotten advice from Jim Baller, a DC lawyer that this might be the Coop's intent to exclude IPTV systems. It's hard to say just what they mean. If we transmit a normal 'broadcast' signal with FTTH we will clearly be considered to meet this section. However, we have not yet chosen this technology.

If it turns out that the Coop is not going to let in IPTV providers, then we have a technical solution. My business plan did not anticipate IPTV (but then again, two years ago when we did that plan there were almost no IPTV providers).

Anyway, this is possibly a bit of a trick question.

The second, and much more problematical question for us is whether we intend to serve customers in the next six months. Under the fastest possible scenario that is not possible and our probable first customer would either be at the end of 2009 or more likely in spring 2010. Thus, we are not going to be able to truthfully answer that question. I'm not sure we ought to try to get in anyway since I'm not sure of the consequences of stretching the truth on this first form.

I'd like to have a call with you, Milda to talk about this issue so we can make a decision of what you ought to do. Filling out the actual form is easy. Whether we should try to move forward now is the harder question.

We have never talked about a specific method of customer rollout. One way to build a system is to build the backbone fiber everywhere and then begin selling customers in town. However, a faster way to get the first customer is to have all of the electronics ready when the first fiber is ready and start serving customers one street at a time while this is being built. This second method could actually get us customers next summer, assuming we had a central office ready very quickly at the beginning of the project. However, even that date is more than six months from now. In any case, I'm not sure we are ready to answer this question until we have had the referendum.

Doug

New year...new news. Be the first to know what is making headlines.

Wally Wysopal

From: [REDACTED]
Sent: Tuesday, December 23, 2008 10:13 AM
To: Wally Wysopal
Cc: [REDACTED]
Subject: Re: Qwest data request

Sorry I didn't reply sooner. Joel has recommended that we give it to them. It's my opinion that either the whole thing is a trade secret or none of it is. There really are no specific items within the report that we can black out since everything flows from beginning to end and if you want to hide a few of the inputs you would end up blacking out most of the report.

My preference is to give it to them in paper format. Quite honestly, if you print the whole thing out on paper it is so large as to become nearly unusable - it's just too big of a pile of paper. Joel - can I assume that giving it to them on paper is being responsive?

If we can't give it to them on paper, then I'd like to go through and kill all the formulae and just keep all of the numbers. This also makes it hard to decipher, yet hides nothing.

What I would prefer not to do is to give them a live spreadsheet where they could fiddle around with the numbers. But showing them the results is normally considered responsive.

Let me know your thoughts.

Doug

In a message dated 12/23/2008 11:44:43 A.M. Atlantic Standard Time, [REDACTED] writes:

Doug-

I need to prepare a response to Qwest's request for the business plan. Please review the plan in light of trade secret information. Thanks

Wally

One site keeps you connected to all your email: AOL Mail, Gmail, and Yahoo Mail. [Try it now.](#)

Nate Ehalt

From: [REDACTED]
Sent: Monday, November 10, 2008 11:30 AM
To: Nate Ehalt
Subject: Re: Fiber Question

The assumption is that the fiber business would be self-supporting and thus would not require any tax increases. Only under a scenario where something went very bad would there be any draw on taxes. Even then, the draw would not be for the total cost of the fiber project because one would have to assume that the business would still be generating significant revenues even under an under-earning scenario. Thus, there is no easy answer about the possible drag on taxes. This is generally something that is looked at hard when you issue bonds and this is one of the questions generally asked in a Preliminary Official Statement (POS). However, I don't have any easy answer now. in a nutshell, the answer is that the tax risk will be for some portion of the cost of the bond, but not for all of it.

As far as prices, I have the competitors prices as of the date we looked at this at the beginning of this year. It's possible that there has been price increases in cable rates since then and it's possible there have been changes in data rates.

My model assumes that the City business will be roughly 15% less than the competition.

However, I would caution that it is far too soon to put out expected rates. it is my experience that once these are published that it becomes very hard to every get away from the perception that is given from those first rates. Typically our rates will be set very near to customer launch. That might be at the end of next year if everything goes perfectly or the year after if we hit any construction delays. In either case these rates are 2 years to 2.5 years later than the rates we first used to do the analysis, and those rates are certainly going to be higher than they were when we looked. Because of this, the model is conservative in that the rates in the model are probably lower than the rates we will charge (as is also true of the competition).

Thus, I would caution very strongly about giving out rates to anybody, including the Council, and definitely the public. I would strongly recommend that instead that we talk about our pricing philosophy, which will be to set rates around 15% lower than the competition at the time we finally are ready to offer service. We can't know what will happen to the competitor's rates between now and then, but our we know our generally philosophy on how we will set rates.

Please call me if you want to discuss either of these two issues more.

Doug
202 255 7689

In a message dated 11/10/2008 1:13:54 P.M. Atlantic Standard Time, [REDACTED] writes:

Doug,
Do you have the actual amount of an increase in tax a household would pay for the bond we would have to secure to pay for the completion of the fiber network? Also, do you have comparison rates for a triple play option for residents that the City would offer vs. the leading competitors, as well as what a business would save on internet service under the fiber option? We are trying to put together a PowerPoint presentation and are looking for some more information.
Thanks,
Nate

Nathan Ehalt
Assistant to the City Manager
City of North St. Paul
651-747-2595

Wally Wysopal

From: Terri Heaton [mailto:heaton@springsted.com]
Sent: Tuesday, September 30, 2008 6:08 PM
To: Wally Wysopal
Subject: Broadband bonds

Wally:

You have inquired about the ability to forego an election for this project. I believe that by eliminating the phone service component and finding an existing GO bonding tool, the election could be eliminated. We believe that abatement bonds would work well here. The maximum annual abatement levy cannot exceed 10% of the City's Taxable net tax capacity which allows about \$1,000,000 per year and could finance about \$10,000,000 of bonds--assuming 15 years and 5% interest.

Due to the nature of the experience of Monticello with their broadband and triple play financing challenges, we are suggesting the following:

- 1) Abatement bonds be divided into three distinct components so that any challenge would only result in that bond issue being subject to a lawsuit and held in escrow pending legal outcomes. One for the optic fiber, one for the cable component and one for the internet component.
- 2) Bonds be sold using a private negotiation even though these are GO bonds. The likelihood of a lawsuit is too high and buyers need to be aware and address this early on in structuring the financing.

Due to the likelihood of a lawsuit, our Springsted group feels that it is critical to have a legal opinion now as to whether the proposed bonds and the use of the proceeds are legal. Although Mary Ippel has stated that she wouldn't be here if their firm didn't agree it was legal, that doesn't give you, the City Council, your city attorney and the other members of your working team, the necessary information to weigh the potential legal case and make an informed decision on whether the risk threshold is acceptable. The laws and cases for and against this project going forward should be identified and addressed as to how they might impact the City of North St. Paul, should this project go forward.

The Monticello case may result in new laws that may change our course of direction, but a solid baseline is needed for where things stand today.

Items we recommend getting legal assurance in writing on:

- 1) Under what laws can the City operate broadband, cable, and internet services? What is the scope and are there any restrictions?
- 2) Are Abatement Bonds a suitable choice for financing?
- 3) What concerns should we have about directly competing with the private sector for broadband, internet and cable services?
- 4) Is there case law we should know about that will give us an idea of how well the City may fare?
- 5) What about Monticello, MN. Anything we should do to separate ourselves from that case from a legal standpoint?
- 6) What about current pending federal legislation regarding providing advanced telecommunications capability? (Senate bill 1294 introduced 6/23/2005 and others)
- 7) Would cutting out the telephone service and using abatement bonds allow the City to proceed without a referendum?

Please let me know if you would like to discuss further or if you have any questions. Thanks again for your time last week--we have you on our calendar.

Terri Heaton, Senior Vice President
Client Representative

Wally Wysopal

From: [REDACTED]
Sent: Monday, March 10, 2008 11:01 AM
To: Wally Wysopal
Cc: [REDACTED]
Subject: Revised financial models
Attachments: NSPFinancial 031008.xls

Wally:

Here is a revised financial model. it makes two fundamental changes.

First, we only install on ONT and drop for those customers who sign up for service.

Second, I've cut the fee for the electric company from \$15 to \$8 and further only charged the fee to those homes that have ONTs.

The bad news is that none of these models work at a 60% penetration. They all bleed cash year after year.

Let's look more closely at the HBC model for an example of the issues. If you recall HBC had made a very low offer of the monthly fee they would be willing to pay for access to the network. This model doubles their proposed amounts. Since the model assumes that HBC does almost everything, the model only has a modest expense for your company each year of \$50,000. Even were your expense zero this model would not work. The HBC and electric fees combined are not as high as the bond payments.

I'd note that even the retail model doesn't work. This is the model where the City is the provider directly. That model goes about \$2M negative on cash and then slowly improves over the years. It's possible that the retail model could be made to work with a different bond schedule that had lower payments in the early years.

But all of the wholesale models will require a significant electric subsidy in order to work. When I set the electric rate at \$15, that really was a subsidy. If electric doesn't pay the subsidy, then the City would have to pay in some manner instead.

As we discussed last week, about the only way I can see this working is if the electric company somehow pays for part of the network. Maybe if we reduce capital costs then the lower bond payments can be met. However, I'd note that having electric pay for part of the network is probably just another way of funding the same subsidy. In the end I just can't see any path that will work with the two proposed retailers, or probably any other retailer.

I'd note that this is not entirely unexpected. The only real places using a wholesale model today are in Utah and those businesses are losing money. In this case, think of it this way. If a commercial provider was to build this network and operate it, this model predicts that they would break even on cash over 25 years. If we then try to take that same model and divvy up the revenue stream between a wholesaler and a retailer there is just not enough cash to make both parties whole.

I'm now of the conclusion that we can't make a wholesale model work without some sort of subsidy. I know that's not what you were hoping to see, but that's what the numbers tell us.

Doug

It's Tax Time! [Get tips, forms and advice on AOL Money & Finance.](#)

Wally Wysopal

From: BLACKBEAN2@aol.com
Sent: Friday, December 05, 2008 6:25 AM
To: [REDACTED]
Cc: Wally Wysopal; Nate Ehalt
Subject: Re: Invite letter from the City of North St. Paul

Milda:

I can talk today at: 8:00 central, 10:00 central, 11:00 central. I am widely available Monday.

Just some thoughts:

1. While we don't want to be uncooperative, we aren't obligated to turn anything over to somebody like Qwest without a formal request for documents. We ought to willingly share whatever we think we want to share, but I would not share anything else on an informal request like this. While I haven't seen the minutes of the meetings Qwest is asking for, I'm going to guess that these documents are not going to give him a very good picture of what we the City has in mind. The best way for them to get up-to-date on that is just to meet with Wally and hear the city's story. Thus, we might want to tell him that in any response. The invitation to meet is the city's attempt to be as open as possible with Qwest and the city is not trying to hide anything.
2. Wally hired me to prepare a financial business model, but there was no 'feasibility study' as such. There is no written report. I believe that over the months we have probably discussed all of the same issues that would be covered by a typical feasibility document, but Wally spared himself the expense of getting it all written down in a formal report. I would advise not willingly sharing the financial business model with Qwest without going through a formal document request. But that financial model is not a feasibility study.

Doug

In a message dated 12/5/2008 2:36:55 A.M. Atlantic Standard Time, [REDACTED] writes:

Joel:

Please evaluate the document request below from Qwest.

Presumably items 2, 3, and 4 are already published to the public by virtue of being on the website or distributed to Council.

Please speak to item 1. No feasibility study was prepared and so no contract for that exists as far as I am aware.

If you can, give me a call Friday morning and then we need to coordinate a call with Wally. I was told by Doug that as of Wednesday he would be available on Friday. I am available up to 1:30.

Wally Wysopal

From: [REDACTED]
Sent: Monday, June 23, 2008 12:43 PM
To: Wally Wysopal
Cc: [REDACTED]
Subject: Re: HBC

After I look at the numbers, the next logical step would be a meeting with HBC. I agree this has good potential and will set it up.

As far as doing an RFQ, we ought to talk to the City attorney. If you are able to reach such an agreement by using the informal process we are undergoing now, then I see no reason to go through the very public process of doing an RFQ. I think any steps we take to keep under the radar are good ideas. In the ideal world I'd like Qwest and Comcast to know you are really doing this to be the date when the Council votes to authorize the bonds.

Doug

In a message dated 6/23/2008 12:50:04 P.M. Eastern Daylight Time, [REDACTED] writes:

Doug-

I am very familiar with this model as it mirrors our electric agency (MMPA). It has worked very well for us so I could be very supportive of such a model for fiber services. This hybrid may be the route to go especially if the numbers work out. It may be worth doing an RFQ and see who is interested (Velocity?). There are many questions regarding the details of the model such as the scope of management services and employment relationships. I would like to meet and discuss.

Wally

From: [REDACTED]
Sent: Monday, June 23, 2008 11:33 AM
To: Wally Wysopal
Cc: [REDACTED]
Subject: HBC

Wally:

I talked with HBC this morning. We have had several conversation over the last few weeks to see if we could get to some point where it looks like some sort of partnership is possible.

Upon further consideration, and more as a philosophical change rather than a reaction to the specific deal with you, they say they are no longer interested in deals where they would lease the whole network and operate it. While they gave us a proposal to do that, they want to withdraw that proposal.

However, they are interested in a deal where the City agrees to be the retail provider but HBC comes in and manages the company for you. This is the deal they have with Monticello when that finally clears the lawsuits and they are very interested in such a deal with you. Such a deal could be for a few years or could be permanent.

This is sort of a hybrid idea. The revenues of the company go to the City. It is your enterprise. However, the business is managed by HBC on your behalf. The City would thus be in the retail business but would not be running the telecom business on a day-to-day basis. There are other cities who operate telecom using this model and a whole lot more who operate electric this way.

They gave me some numbers to use in order to see just how that would work for you and I will get that to you later this week.

Wally Wysopal

From: [REDACTED]
Sent: Wednesday, December 10, 2008 5:29 AM
To: Wally Wysopal
Subject: Re: Alternative Financing

I think it's a wonderful idea. I would voice several concerns that ought to be addressed:

1. There is not any profits for quite a number of years and the project is expected to basically pay for itself for a decade. Many bonds would not allow for any cash payout to investors until such time as the bonds have been retired. The investors need to understand the expected cash flows and the expectations for the business. However, in the long run the project could peel off millions in cash.
2. One would have to be concerned that they would want to operate the business. In my opinion, your success is going to come from the public viewing this as a municipal venture, not a commercial venture. I think it would be important for the City to be in real control, at least for operations. To give you an example of the difference between public and private companies, municipal overbuild ventures have gotten north of 60% penetration rates while very few private ventures have gotten 50%. I think the difference is due to the faith the public has in how the government will treat them.

However, these are not deal busting issues and it is an exciting idea. How can I help to move this forward?

Doug

In a message dated 12/9/2008 11:37:41 P.M. Atlantic Standard Time, [REDACTED] writes:

Doug-

A group of well healed local investors are considering the possibility of privately financing the \$18 million bond for an equity stake in the operation. They would reinvest the profits into other economic development projects; a sort of local development commission.

Your thoughts.

Wally

Make your life easier with all your friends, email, and favorite sites in one place. [Try it now.](#)