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February 28, 2011

**HAND DELIVERED**

Susan M. Hudson, Clerk  
Vermont Public Service Board  
112 State Street – Drawer 20  
Montpelier, VT 05620-2701

Re: Petition of City of Burlington d/b/a Burlington Telecom to amend Condition No. 17 of its Certificate of Public Good, enlarging the date by which it must complete its system build out  
Docket No. 7044

Dear Sue:

Please consider this letter the third progress report of the City of Burlington ("City") d/b/a Burlington Telecom ("BT") as required by Paragraph 10 of the Board's Order in the above-referenced matter dated October 8, 2010. Reference should be made to BT's prior progress reports dated November 1, 2010 and December 30, 2010 for additional background information.

Since BT's last status report the City has received two letters of intent ("LOI") in connection with BT. The first is from an out of state independent telephone company, and the other is from a financial investor with significant telecom and cable experience. The parties have submitted their proposals under non-disclosure agreements, however the City has permission to describe the proposed transactions, both of which contemplate change in control of BT.

The first LOI proposes to provide new equipment in order to facilitate the return of the CitiCapital equipment with the exception of the fiber, which would be replaced using a like-kind exchange. The transaction would take the form of an asset sale, and the City would not have a continuing ownership interest in the new entity. The LOI proposes an excess cash flow payment to the City for a period of six years.

This LOI includes a "no-shop" or exclusivity provision, a 60 day due diligence period and a July closing. The party has visited Burlington and participated in numerous due diligence

calls. While there are a number of positive elements to the proposed transaction, including the potential for repayment of the debit to the cash pool, Dorman & Fawcett ("D&F") has advised the City that the LOI is not acceptable in its present form. D&F also has advised that the timetable is optimistic in light of the pace of discussions to date with CitiCapital. The party has responded favorably, and just last week provided a revised LOI to D&F. D&F is presently reviewing the revised LOI, which has been modified extensively to include, among other terms, a minority equity stake for the City and minimum cash flow distributions in years 2 - 12. The revised LOI requires further revision, but the progress is positive.

The second LOI is from a financial investor, who has also visited BT, who has proposed a cash payment to CitiCapital as part of an overall asset purchase. The LOI includes a settlement budget that D&F has advised will likely not be acceptable to CitiCapital. The LOI also contemplates the City receiving a minority interest in the new entity. Until CitiCapital provides further feedback in connection with a cash settlement, D&F does not expect further progress with this party.

D&F is in discussions with two other investors/buyers, one of whom recently spent three days at BT and has been engaged in deep due diligence. This party is well financed and understands that BT's debit to the cash pool must be addressed as part of any LOI. D&F expects to learn in March if this potential buyer intends to proceed.

In early February, representatives of CitiCapital requested a status report on the new equipment financing, and also inquired about how much the City or a third party would be willing to pay to CitiCapital in lieu of returning the equipment. A letter was submitted on behalf of the City by D&F on February 10, 2011. The letter advised that, to date, all of the interested parties have been told they must provide funding for new equipment. It also confirmed any cash settlement proposal will be subject to the terms and conditions of the investor/buyer, and that the City is prohibited from entering into a cash settlement with CitiCapital that utilizes non-BT funds. To date, CitiCapital has not formally responded to the February 10<sup>th</sup> letter from D&F. D&F has spoken to representatives of CitiCapital during the past week to keep them abreast of refinancing/equipment return alternatives.

In light of the pace of discussions with CitiCapital to date and the fact that those discussions are tied to the terms of investors/buyers, it may take 60-90 days before the City is able to determine the alternatives for resolving the situation with CitiCapital. At present, CitiCapital has not informed the City where it would like the equipment delivered, nor has it commented on the like-kind exchange of the fiber optic cable. Absent resolution of these questions, the City is required to move at CitiCapital's cadence.

Fortunately, BT is on a solid operating footing. Since September 2010, D&F has assumed management and operational responsibilities at BT. Stephen Barraclough of D&F, BT's interim general manager, along with another D&F resource located on-site at BT, have worked to ensure that the new financial disciplines implemented at BT are adhered to, and that tight control is maintained over all aspects of BT's financial performance. As a result, BT is

organized and operated like a business, with clearly defined managerial accountability and responsibility.

One area of significant improvement is in the area of budgeting and monitoring of financial performance. Previously, BT operated pursuant to a municipal annual budget and appropriation process. For Fiscal Year ("FY") 2011, a monthly budget was created, and a monthly financial and operational reporting and review cycle instituted. This process includes monthly hard closings, financial statements for profit and loss, balance sheet, cash flow, aging of payables and receivables and key operational performance metrics. Cash is now posted daily, and City-initiated entries for cost allocations are made and subsidiary accounts reconciled on a monthly basis. With management review of monthly financial results, the process enables BT to regularly reforecast its overall business outlook for FY 2011 and take appropriate, timely action to ensure that BT remains on course.

Managing costs and cash flows, from the top down, has ensured that FY 2011 expenditures are limited to only those necessary to run the network, increase sales, or improve customer experience. Improved cash management disciplines have been instituted and ongoing cash management remains a priority to ensure that BT does not increase its debit to the City cash pool. A purchase order requisition system has been established as an effective cost control measure to ensure that no unapproved expenditures are made. This system ensures up front, before an invoice is received, that the proper expense/capital account is being charged. No invoice is approved for payment without a valid purchase order and a packing slip, ensuring that materials are indeed received.

A comprehensive review of the processes performed by the Accounting Department has been undertaken to identify areas that were non-value added or not conducive to month-to-month reporting. BT's use of an external collection agency for delinquent accounts was not cost-effective, and has been brought in house, utilizing BT's Customer Service Representatives to make courtesy calls. Other processes have been streamlined and automated, with better use made of existing financial software. Changes made have not only ensured proper accounting, but have also improved productivity.

BT's staffing and expenditure levels, across the business, have been right sized to match its current underlying level of activity. Remaining staff, whose efforts have historically been focused within a limited range of deliverables, are now being cross trained to ensure more effective coverage across disciplines. Reliance on expensive outside services for marketing and installation activities has been curtailed, and necessary ongoing work brought in house. BT staff and management continue to work closely with D&F and Hiawatha Broadband Communications ("HBC") to successfully implement financial and operational changes under demanding circumstances.

BT has received significant ongoing operational assistance from HBC, and particularly Gary Evans, a founder and HBC's longtime CEO. Mr. Evans is present in Burlington twice a month working alongside BT's management team as an operational partner. HBC, an over builder based in Winona, Minnesota, a city of similar size to Burlington, operates as a private,

for profit business in a competitive marketplace. HBC is cash flow positive, profitable and enjoys market shares in excess of 70% in both residential and commercial markets, in each of the local communities it serves. Its reputation and market shares have been built as a result of a focus on outstanding customer service and experience and integration into and participation with the local communities. While Burlington is not Winona, HBC's success holds many valuable learning experiences for BT and many advantages for Burlington.

Mr. Evans' and the HBC management team's input and guidance have been instrumental in enabling BT to continue to operate effectively in challenging circumstances. Every operational area and discipline at BT has now been reviewed in detail. BT's current processes and practices have been benchmarked against D&F and HBC best practices, and areas requiring change and improvement clearly identified. HBC's best practices in sales and marketing are now being shared with BT, and a comprehensive new marketing plan is in its early stages of formulation, with active participation and input from members of the Burlington community.

To address a situation where BT's current equipment is returned to CitiCapital, BT's technical staff has worked closely alongside and under the guidance of HBC to undertake a detailed review of BT's technological infrastructure and capabilities, identifying replacement equipment requirements and necessary upgrades, and negotiating pricing and availability with vendors. Detailed swap out plans, cost estimates and timelines have been developed to enable replacement of equipment at BT within a 60-90 day window, with minimal disruption to BT customers.

As a result of the foregoing operational and management changes, BT is now producing sufficient cash flow to service operational requirements, including capital expenditures, and generates approximately \$40,000 a month in additional cash flow that could be applied towards debt service. BT has not had any additional debit balance against the City's cash pool for the past six months, and normally maintains a positive balance in its bank account of between \$150,000 - \$300,000.

Paragraph 9 of the Board's Order of October 8, 2010, requires BT to "file with the Board by December 31, 2010, or such later date as the Hearing Officer shall determine, specific language for the proposed amendment of Condition 17 and a more detailed statement as to the specific relief it seeks from the financing limitations of Condition 60." Docket 7044, *Order on Motions and Cross-Motion for Partial Summary Judgment*, 10/8/10 at 33. On December 30, 2010, BT filed a Motion for Enlargement of Time to extend the date by which BT must file the specific language required by Paragraph 9 until February 28, 2011. To date, this motion has not been acted upon by the Board. BT still is not in a position to provide the specific language required by Paragraph 9. To allow the negotiations with potential investors/buyers and CitiCapital to continue, BT hereby requests that the Board grant a further extension of the Paragraph 9 filing date to June 30, 2011. BT would still file its next detailed status report as required by Paragraph 10 of the Board's Order on April 30, 2011.

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As always, your assistance is greatly appreciated. If the Board needs anything further in this regard at this time, please let me know.

Very truly yours,

A handwritten signature in cursive script that reads "William F. Ellis".

William F. Ellis

WFE/  
cc: Docket 7044 Service List