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OFFICE OF
THE CITY ATTORNEY
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TO:	Mayor and City Council
FROM:	City Attorney Eileen Blackwood
DATE:	September 7, 2017, updated October 2, 2017
RE:	BT Sale Legal Issues

As the various proposals to purchase BT have been being reviewed, some legal issues have arisen that should be taken into account as the Mayor and Council consider the potential purchasers. One issue involves the role of the Public Utility Commission; the second involves the role of Blue Water, and the third concerns the role of Dorman & Fawcett. The first issue came up in the context of evaluating the various proposals for the City's carried interest. I then asked our outside counsel Ralphine O'Rourke at Primmer, Piper for an independent opinion, particularly focusing on what risks would arise from a Council decision to roll over some or all of the City's net sales proceeds. Her legal memo is attached but is summarized below.

This memo also addresses some additional legal issues that were discussed at the Council's September 25, 2017 meeting.

Regulatory concerns for Public Utilities Commission approval and carried interest investment

The purchase and sale agreement for this transaction will ultimately be subject to the review and approval of the Vermont Public Utilities Commission (PUC) (formerly known as the Public Service Board), which must grant the buyer a Certificate of Public Good (CPG) before the sale can close. In its process, the commission will give great weight to the opinion of the Department of Public Service (DPS), particularly in relation to the statutory and so-called EMCO criteria that the PUC will ultimately evaluate. Those PUC criteria are set forth in the criteria for sale of Burlington Telecom, adopted by the Council April 25, 2016, and in Attorney O'Rourke's attached memo.

Rejection of the sale by the PUC would put the City in a very difficult position, as by the time that decision is made, the City will have missed important deadlines in the agreement with Blue

Water, and will be in a substantially weaker negotiating position with future prospective partners than it is in today.

Given the regulator's criteria and role, the City must consider how the PUC will view this transaction.

- Both the DPS and the PUC are likely to more easily approve an entity with a demonstrable track record of success in managing a municipal telecom and demonstrable access to capital, rather than a first-time cable operator, as they are charged with considering both the financial stability and operational experience of the proposed company. The regulators are likely to subject to greater scrutiny an entity formed solely to purchase BT, which has no experience actually operating a telecom business, than they would more established and better capitalized companies.
- The regulators are likely to look favorably upon the return on the City's existing investment into BT that will flow from a higher sales price and may not support a City decision to accept a lower valuation without strong justification, as returning less benefit to the taxpayers.
- Two of the finalist bids currently before the Council would allow the City to opt to reinvest its "net sales proceeds" in a carried City interest in the future BT entity and one requires that reinvestment. However, in considering that carried interest, the PUC will still have to evaluate the existing charter provisions about our telecom authority, as Attorney O'Rourke describes in her attached memo. If the PUC believes the City investment is speculative and could result in losses, it may hesitate to agree to a carried interest. Even if the PUC allows some carried interest, it may require the City to take some of the net sales proceeds in cash in order to ensure that the taxpayers have seen some return and may require certain legal protections against losses (more fully described in Attorney O'Rourke's memo). The legal team recommends that whatever proposal is taken to the PUC should include the option to take the entire net sales proceeds in cash if the PUC requires that.

Blue Water Approval

An additional challenge to be considered is that Blue Water has an interest if the sale is to a first-time operator.

In the BT Management and Sale Agreement with Blue Water that was approved by the Council in 2014 (and called out again specifically in the criteria for sale of Burlington Telecom adopted by the Council on April 25, 2016) is the City's right to direct the sale of BT to a "Qualified Purchaser" that has the "capability of operating a telecommunications company of size and service similar" to BT and is "reasonably expected to satisfy any statutory criteria in order to obtain a certificate of public good from the PSB. Such a purchaser "may be a first time operator if [Blue Water] reasonably determines such first-time operator to be able to timely obtain a certificate of public good from the PSB."

An option that involves a first-time operator (that is, an entity that has never operated a telecom), therefore, faces the added risk that Blue Water may reject that purchaser. That risk of rejection may increase if Blue Water believes it is negatively affected by a lower purchase price.

Potential for Perceived Conflict of Interest

Dorman & Fawcett (D&F) has been wearing many hats over the past few years, and from time to time the issue of conflict of interest has arisen. D&F agreed to defer its fees during these past several years, allowing them to accumulate and be paid at the sale, in return for receiving 10% of Blue Water's interest in the net sales proceeds. From the City's perspective, this arrangement seemed to give D&F an incentive to find a purchaser, at a good price, who could receive a CPG in a timely manner; their interest therefore seems aligned with the City's interests. However, the Council's April 2016 Resolution on the BT Sale Criteria specifically acknowledges that others may perceive D&F's financial interest as creating a conflict of interest, or the perception of such a conflict, such as an interest in accepting the highest offer. That is a perception the City has kept in mind throughout this process.

Initially, some of the bidders had included a continuing role for D&F after the sale, either as operator or with the option to roll over its sale proceeds into an equity stake in the future entity. Because of concerns that this continuing role could be perceived as a potential conflict of interest, D&F has informed all the finalists that none of the bids should be based on D&F's having a continuing role in the new entity beyond a transition period.

Other Legal Interests

In 2014, the City entered into a settlement agreement with Citibank that was "predicated on the assumption that the [financing with Blue Water] is intended as a bridge to the eventual arm's-length sale of the System to a private entity." After the closing of that sale, the City is to share 50% of its portion of the net proceeds of the sale with Citibank. Citibank, therefore, has an interest in what the net proceeds consist of, and the City must evaluate in good faith how the finalist's proposals will address Citibank's interest. A proposal that fails to treat Citibank's interests equivalently to the City's so that it realizes its 50% share is likely to face legal challenges.

In 2009, Burlington taxpayers sued the City and its former CAO Jonathan Leopold for having spent $17 million of taxpayer money on BT, despite the charter provisions requiring that taxpayers not suffer from BT's losses. The claims against the City were ultimately dismissed, but some taxpayers may raise new claims if the City chooses a bid that they believe is not as beneficial to the taxpayers (as opposed to the subscribers of BT) as another option. Thus, the interests of taxpayers, as well as those of BT subscribers must be considered.

When BT is sold, the employees of BT will end their employment with the City. Currently, the City's pension plan has an unfunded liability, a portion of which is attributable to those BT employees. For the year ending June 30, 2016, that amount was $1.1million, but it fluctuates from year to year depending on market conditions and other factors. When BT is sold, the City will need to contribute to its pension plan from the net sales proceeds some amount to cover that liability, and as soon as the City's new actuaries are on board, there will be a better estimate of what that amount will be. However, it is likely that the City will need to take at least some portion of its net sales proceeds in cash.

Summary

From a legal perspective, the state regulatory agencies are more likely to approve a proposal that involves an established, independent company with experience in telecom operations and a significantly higher valuation and access to capital and would look less favorably on one that involves a new company with a much lower valuation. . The state regulators may hesitate to allow the City to roll its entire net sales proceeds into the new entity, and if rollover is allowed, will likely require protections against losses. Blue Water, Citibank, and non-subscriber taxpayers all have interests that must be considered to avoid legal challenges.