

A Decade Lost – The History of MI-Connection

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The Background

Prior to MI-Connection, in the 1990's, a succession of operators provided service to the Lake Norman region starting with Lakeside Cable Company, followed by Prestige Cable which was then purchased by Adelphia Communications. These operators provided minimal service because the area at the time was considered rural and investing in the region was deemed financially unwise. Overall service levels were extremely poor for the towns of Davidson, Cornelius, Huntersville, Mooresville and Troutman whose total population was less than 35,000 (Estimated 2017 total is over 225,000).

Back in the 1990's, towns issued companies "cable franchise agreements" in order to do business in the town. After the two turnovers with Lakeside and Prestige, the towns negotiated with Adelphia that a "right of first refusal" be included in their franchise agreement should Adelphia decide to sell the company/system yet again.

The following is a timeline that explains the actions, financials and complexities involved which have resulted in the current state of affairs of MI-Connection.

In June of 2002, Adelphia Communications filed for bankruptcy as a result of criminal convictions and impropriety.

In 2005, as part of the plan to emerge from bankruptcy, Adelphia agreed to have Time Warner and Comcast acquire its cable systems in order to pay off the debt owed. North Carolina systems were to be acquired by Time Warner. During this process, the towns spoke with Time Warner representatives, expressing their concerns about poor service, lack of investment and the need for a better system given the explosive growth occurring in the region. Time Warner indicated they had no plans in the immediate future to make any investments into the system and they were not going to honor the franchise agreement.

Since Time Warner refused to upgrade the system and provide an Institutional Network (giving towns access to fiber to connect facilities), the five towns asked the bankruptcy judge to grant the towns the opportunity to exercise their right of first refusal, believing Time Warner would then honor the franchise agreement and upgrade the system.

The judge granted the towns their request. The five towns then organized a task force and spent over \$2mm to analyze the business and evaluate the investment as a growth engine for economic development, as well as, a potential revenue source to the towns.

During the towns' due diligence phase, the bankruptcy judge removed the towns' area from Adelphia's sale to Time Warner. However, Time Warner was named as the steward of the system and operated it while the towns completed their due diligence.

In 2006, after completing the due diligence, Huntersville and Troutman opted out. Huntersville opting out also resulted in Mecklenburg County opting out. Cornelius indicated they were not interested in the deal, but would allow Adelphia customers in Cornelius to be transferred to the new system. Mooresville and Davidson re-ran the business model without Huntersville's and Troutman's customers and decided to move forward despite citizen opposition based on philosophical views that towns should not be in the cable business.

When Davidson and Mooresville indicated their desire execute their right of first refusal and purchase the Adelphia system, the judge then set the price of \$3,810 for each customer. The towns appealed the price to the judge but lost the appeal. Additionally, the towns had to pay for the system. Time Warner was not pleased about losing the opportunity and was less than helpful during the transition.

The deal to purchase the system took almost a year to finalize, during which time several parallel efforts were underway:

1. The Inter-Local Agreement

While the purchase of the system was being completed, Davidson and Mooresville prepared an Inter-local agreement for the joint operation of the cable system. The towns would borrow \$80 million (to pay for acquisition and operating capital) and formed MI-Connection (stands for Mecklenburg Iredell – Connection; also a play on words as “My” Connection since the citizens owned the system).

The Inter-local agreement originally stated that Davidson and Mooresville would benefit financially based on the % of customers each town provided on an annual basis. At the end of each fiscal year (June 30th), the % split would be calculated and the towns would receive their % of the net profit or decide to re-invest it back in the company. No one ever anticipated losing money, but the same % applied if subsidies were needed.

At the time of purchase in 2006, Mooresville had 7,000+ customers and Davidson had 3,000+ customers - the split was 70/30 Mooresville/Davidson. Cornelius' customers that were transferred to the new system were added to the customer base for reporting purposes but were not included for the % split calculations.

Furthermore, Mooresville carries all the debt and handles the financial transactions between MI-Connection and the towns. Davidson simply pays Mooresville its portion.

The Inter-local agreement also outlined MI-Connection's operation, management and oversight structure is explained below.

2. Contract to Outsource Management and Operations

Acknowledging their lack of expertise in running a cable business, the towns arranged to outsource the management and operations of the system to Bristol

Virginia Utilities (BVU). BVU received a management fee but the towns maintained control.

3. Establishment of the MI-Connection board to provide direction and oversight authority.

The MI-Connection board was established to oversee BVU and the MI-Connection venture. Initially, there were five at large board members with two year terms each – two from Mooresville, two from Davidson and one member that would alternate every two years between the towns. For example: the first two year term, Davidson had three seats and Mooresville had two seats. The next two year term, Mooresville had three seats and Davidson had two. Two of the seats were filled by commissioners who rotated the chairman role between the towns each year. In addition, Cornelius had an ex-officio seat on the MI-Connection board.

In June of 2007, the court approved Adelphia's plan to emerge from bankruptcy.

On August 13, 2007, after Adelphia's plan was approved, the Town Boards of Mooresville and Davidson were free to vote on purchasing the bankrupt Adelphia system and enter into an inter-local agreement.

Mooresville's board was split on the decision to approve with a 3-3 vote and their former mayor, Bill Thunberg, cast the deciding vote to move forward with the purchase. Davidson commissioners John Woods, Evan Webster, Margo Williams, Bruce McMillen and Cary Johnston voted unanimously to approve the purchase.

Once the approvals were completed, the towns signed the inter-local agreement, borrowed the \$80mm, finalized the contract with BVU and seated members on the MI-Connection board. Evan Webster served as MI-Connection's first chairman beginning in August of 2007.

In November of 2007, Brian Jenest, Bill Johnson and Laurie Venzon were elected to the Davidson Town Board along with previous board members, Evan Webster and Margo Williams. John Woods became the Mayor.

Note: As shown in the above time-line, Brian Jenest, Bill Johnson and Laurie Venzon did not vote for the purchase of MI-Connection as they were elected after the purchase was completed. In addition, as a business woman, Laurie Venzon is on record stating that she does not support government running a business, especially one outside its sphere of expertise and knowledge.

In April of 2008, as the transition from Adelphia/Time Warner was underway, the towns had to borrow \$12.5mm pay for additional customers Time Warner said they "found" during the transition and neglected to include in the customer base. The total debt now was \$92.5mm.

Note: To make matters worse, MI-Connection later determined these customers were actually Time Warner's "bad debt" customers and not true paying customers. It took MI-

Connection a year to collect the equipment from these non-paying customers. By the time this was discovered and legal action considered, the statute of limitations had expired.

By early 2009, after 1 full year of operation (once the transition was completed), MI-Connection was **unexpectedly** losing money and the number of customers had decreased. Laurie Venzon asked her husband, John Venzon, to review the business since he had experience in turning businesses around. John conducted a free consulting study and reported his findings back to the Davidson Board and Mayor Woods.

The report indicated the difficult transition and upgrade, economic down-turn and the loss of two apartment complexes' business all contributed to MI-Connection's loss in subscribers. MI-Connection had no choice but to grow its customer base as it could not cut expenses enough to make it more profitable. Davidson's board and mayor made a huge effort to encourage their citizens and businesses to support MI-Connection and use the system.

BVU continued to manage and operate MI-Connection, but the situation did not improve.

In May of 2009, during the 2009-2010 budget process, the towns were informed that for the upcoming July 1, 2009 – June 30, 2010 fiscal year, MI-Connection was down 1,200 customers from the previous year creating a funding gap. MI-Connection requested from the towns its first subsidy - \$576,000. Based on the customer count at the time, Mooresville paid 69% (\$396,415) and Davidson paid 31% (\$180,189) because Davidson was growing their customer base faster than Mooresville. Had there been a profit, Davidson would have been rewarded with a larger share of the profits; however, since there was a loss, Davidson had to pay a larger share of the subsidies.

In August of 2009, given the poor performance, the town boards made changes in MI-Connection's board since the current members terms were up for renewal or expiration. They selected a new chairman from Mooresville, John Kasberger and John Venzon replaced Evan Webster to fill one of Davidson's seats on the MI-Connection board.

Throughout the remainder of 2009 and into early 2010, BVU struggled to right the ship. MI-Connection continued to lose customers, especially in Mooresville where the citizens' anger was in full force and they did not want to support the system. Mayor Thunberg (who broke the tie in Mooresville and voted for the purchase of the system) lost his 2009 November re-election bid for mayor. MI-Connection found itself in the middle of a political crossfire and it only continued to hurt the company's ability to grow its customer base.

In May of 2010, during the 2010-2011 budget process, the towns were told the subsidy needed for the upcoming fiscal year July 1, 2010 – June 30, 2011 was **\$6,460,000!** Davidson's 31% share amounted to \$2,019,000 (more than 10% of the town's budget) and it was not a good situation. Davidson had to lay-off staff and cut back on services.

In August of 2010, John Venzon became the Treasurer of the MI-Connection board and started to dig into BVU's numbers to determine why the company was continuing to lose money.

Also, that fall, after several years of struggling, followed by the huge subsidy request, at the recommendation of the MI-Connection board, the towns decided it was time to hire their own CEO and bring the management of MI-Connection in-house (instead of using BVU).

In March of 2011, the towns and the MI-Connection board hired industry expert, David Auger as a consultant to unravel the BVU operating contract. In addition, the towns amended their Inter-local agreement (effective April 1, 2011) to reflect a new board composition that would allow the MI-Connection board to focus on running the system like a **business rather than utility**. The towns agreed to remove all elected officials and create a board with 7 voting Directors and 2 non-voting Directors.

The voting Directors were comprised of Davidson's Town Manager, Mooresville's Town Manager, 5 At-Large Directors to be selected and approved by both town boards. The 2 non-voting Directors were to be a representative selected by the Town Board of Cornelius and the MI-Connection CEO. Terms and limits were also outlined along with several other changes in the new agreement.

In May of 2011, during the 2011-2012 budget process, the towns were told the subsidy needed for the upcoming fiscal year July 1, 2011 – June 30, 2012 was \$7,014,000. Davidson's portion of the subsidy was now 33% or \$2,340,000 (again because Davidson was growing their customer base and Mooresville was not). The Local Government Commission (LGC), which is the town's financial oversight, was very concerned as these losses were not sustainable and would have required Davidson to raise their tax rate by 12 cents should this level of subsidy have continued (the new tax rate would have been .48/\$100).

In August of 2011, after the new board composition was in place and Directors chosen who had industry, financial, legal or marketing expertise, John Venzon was selected to be chairman of MI-Connection.

Note: From August, 2007- May 2013, board positions were unpaid, volunteer positions. Effective June 27, 2013, board officers began being paid \$250 for each quarterly meeting and regular board members were paid \$150 per quarterly meeting. David Auger and the two town managers do not and have never received payment. John Venzon, while eligible for payment, declined to receive any money for his service on the board.

Furthermore, neither John nor Laurie Venzon profited from MI-Connection in any way. In fact, when they moved to Kansas in 2013, the board asked John Venzon to stay for an additional year to help transition the new chairman. He agreed to do so and paid for his own flights back for the quarterly board meetings, only charging MI-Connection for hotel expenses.

During the fall of 2011, Commissioners Tim Dreffer and Laurie Venzon, along with Chairman John Venzon start to renegotiate the % split with Mooresville to be a static 70/30 split (regardless of number of customers) going forward. Davidson also asked Mooresville to allow them to cap their subsidy payment to MI-Connection at \$1 million each year with Mooresville paying the difference. Davidson would then repay Mooresville in the future.

In December of 2011, at the end of his consulting engagement, the MI-Connection board hired David Auger as MI-Connection's first (and current) CEO.

In 2012, several key actions occur. First, Mooresville agreed to cap Davidson's subsidy at \$1mm annually and the Inter-local agreement was amended. Basically, starting with the 2012-2013 fiscal year, Mooresville has been covering any amount Davidson owes MI-Connection that is over \$1mm and it becomes a liability Davidson owes Mooresville (right now, the outstanding balance owed is approximately \$2mm).

Second, David Auger, the MI-Connection board and team did an amazing job of keeping the business afloat by reorganizing the company and renegotiating contracts with MI-Connection programming providers and vendors.

Third, David Auger recommended MI-Connection change their measurement system from Number of Customers to Number of Revue Generating Units (RGUs). A "revenue generating unit" is a cable customer, an internet customer or a phone customer. So if a customer has MI-Connection's triple bundle service (has cable, internet and phone), that customer counts as three revenue generating units. If another customer only has internet, they count as one revenue generating unit (RGUs continue to be the measurement used today and prior years' numbers were changed to reflect RGUs vs. Customers so year over year comparisons could be made).

Beginning with the 2012-2013 fiscal year, Davidson has been paying \$1mm annually. Had Mooresville been unwilling to help Davidson, the town would have had to continue to pay MI-Connection according to the original agreement terms, which would have gutted Davidson financially. In addition to money, Davidson owes a debt of gratitude to Mooresville for their gesture.

Over the course of 2012-2013 and 2013-2014 fiscal years, David Auger moved all operations in-house and MI-Connection terminated its contract with BVU improving service and substantially reduced operating expenses.

In 2015, the MI-Connection's debt was refinanced to lower the interest rate and reduce payments. Terms and conditions were also renegotiated.

Currently, the 2018 proposed budget projects the towns' subsidy to be \$2.9mm. Davidson's 30% portion is \$879,311 and Mooresville's 70% is \$2,051,727. Davidson will pay \$1mm and for the first time, since Davidson's subsidy portion is less than \$1mm, the remaining \$120,689 will go towards paying down the \$2mm balance Davidson accumulated and owes to Mooresville. This is good news, believe it or not.

The Future of MI-Connection

Since 2013, MI-Connection's performance has continued to improve and the subsidy required from the towns has steadily decreased. As mentioned, in 2018, Davidson will

begin to pay back Mooresville. Hopefully, by 2022, no subsidy will be required and Davidson's debt to Mooresville will be paid in full.

Many citizens are concerned that the technology will not be able to keep pace and the system will become obsolete. Industry experts indicate that it does not appear this will occur in the next 10-15 years. Just, as transportation has changed in the last 150 years and broadened options with the invention of the automobile and airplane, a strong railroad network is still needed to move goods. So too, the fiber network comprising the MI-Connection system will continue to be a viable and much needed means of delivering service.

In addition, video rates for TV continue to increase. Many households may be pulling the plug on cable to use other video streaming options which requires fast internet speeds. MI-Connection annually invests in its infrastructure and has some of the fastest upload / download speeds in the region. The company is well positioned to grow internet services as customers move away from cable and telephone services.

According to the Google Quality Report published in 2014, *"For residents in Mooresville, Davidson, and Cornelius, MI-Connection offers the most comprehensive and affordable broadband high-speed internet solutions alongside the highest quality customer satisfaction.*

This local ISP provider is the only one in the Charlotte region to be ranked as HD (High Definition) verified by the Google Video Quality Report. This means that MI-Connection is the area's leader in providing homes and businesses top quality, uninterrupted digital video."

To see the Google Video Quality Report, visit <http://www.google.com/get/videoqualityreport/>.

The real question remains: Should Davidson, or any government entity, be in the cable/phone/internet business?

Several options for Davidson include:

1. Both towns keep the system and continue to own it.
2. Both towns sell the system once the value (\$50mm) is greater than the debt (\$67mm). Need to obtain more customers and continue to grow the system in order for this to occur.
3. Davidson finds an investor willing to buy its 30% share of the system and refinance the debt instrument (also will have to work through the issues of a publicly and privately owned system).
4. Negotiate a deal with Mooresville to take complete ownership of MI-Connection.

Most Davidson citizens would like for the town to be out of the MI-Connection deal. It's time to develop an exit strategy and actively pursue it, not waiting until 2022. **Based on proposed budget figures, for fiscal year ending June 30th, 2018, the total subsidies paid by the towns from 2010 – 2018 will be over \$40.7mm. Mooresville will have paid \$28.2mm and Davidson will have paid \$12.5mm.**

If we had been able to use the \$1mm / year to borrow money and service debt for our capital expenditures, imagine the infrastructure - roads, sidewalks, parks and greenway connections - Davidson could have completed in the last decade had it not been for MI-Connection. In current dollars, it would have been almost \$14mm. The second fire station could have been fully funded. More importantly, our public safety and public works staffing levels could have kept pace with the tripling growth of the town's population. Instead, staffing levels are barely above what they were in 2007.

From where the state of the system was in 2006 to where it is today, is night and day. There are many people to thank for MI-Connection's current status as one of the fastest networks in the area. And, MI-Connection has distinguished itself through its customer service. It is a good system and will continue to improve. However, Davidson needs to extricate itself from MI-Connection as soon as possible and focus on the business of government.

See Appendix on next page for explanation of why MI-Connection requires a subsidy when it is showing a gross profit.

Appendix:

A resident recently raised a question regarding the 2017 budget numbers: How can MI-Connection have a gross profit and also need a subsidy? An explanation follows:

Revenue	= \$22.5 mm
Less Direct COGS ¹	= \$ (9.2) mm

Equals Gross Profit	= \$13.3 mm
Less Operating Exp	= \$ (7.5) mm

Gives you EBIDA ²	= \$ 5.8 mm
(Earnings <u>B</u> efore <u>I</u> nterest, <u>D</u> epreciation and <u>A</u> mortization)	
Less Cap Exp ³	= \$ 2.9mm

Equals Free Cash Flow	= \$ 2.9mm

From an operating expense standpoint, MI-Connection is making money, however, it still needs to service the debt (about \$67mm - down from \$92mm in 2008) and in order to do so, MI-C needs a total of \$6.3mm. It has \$2.9 free cash flow to apply towards the debt, however that is obviously, not enough. Therefore a subsidy is required.

Debt Service	= \$ 6.3mm
Less Free Cash Flow	= \$ (2.9)mm shown above

Equals subsidy needed	= \$ 3.4mm shortfall required from towns

Davidson's portion is 30%.

As you can see from above, **gross profit** does not include any operating expenses, debt payment, capital etc. Once you factor in those numbers, a subsidy is necessary.

¹Cost to deliver programming and provide services

²Also known as Operating Income

³Capital Expenditures include fiber, equipment, etc.