MEMORANDUM

Date: November 25, 1998

To: Honorable Councilmembers
Seattle City Council

From: Steve Holmes
Director, Office of Cable Communications

Re: Transfer of Summit Communications, Inc.

I. Introduction

Summit Communications, Inc. a Bellevue-based cable operator, holds franchise agreements to provide cable television services in Seattle's Central Cable Television Franchise District and TCI-I Franchise District. Summit also serves the downtown area under street use permits. These service areas are identified in the map attached as Exhibit A. On September 9, 1998, Summit filed an FCC Form 394 indicating its intent to transfer its franchise agreements to Summit Cablevision LP (LP). Subsequent to this transfer, a controlling interest in LP will be purchased by Millennium Digital Media Systems, L.L.C., a St. Louis-based company in cable properties.

City ordinances and Summit's franchise agreements require Summit to obtain "prior approval by the City, and then only under such conditions as may therein be prescribed" before the transfer may be completed. See, SMC 21.60.520. A transfer may not be unreasonably refused; however, the proposed assignee must show financial responsibility as determined by the City Council, must demonstrate to the Council's satisfaction its ability to comply with the provisions of this chapter; and must agree to comply with all provisions of Seattle's Cable Communications Ordinance. SMC 21.60.520. The Council must also give due consideration to the quality of the service proposed, the experience, character, background and financial responsibility of each applicant and its management and owners; the technical and performance quality of equipment; the program proposed for construction; and the applicant's ability to meet construction and physical requirements and to abide by the terms and requirements of the franchise generally. The Council shall also give weight to local ownership and to ownership representing minorities within the larger public. SMC 21.60.260.

A public hearing is required, at which citizens will have the opportunity to express their views orally or in writing. Public hearing on this transfer is set for Wednesday, December 2, 1998, at 2:00 in Council Chambers, before the Council's Public Safety, Health, and Technology Committee. To assist the Council, and pursuant to SMC 21.60, the City's Office of Cable Communications provides this analysis, in which we recommend Council approval of the transfer, with specific conditions and commitments that address the issues set forth below.

II. Backgrounds of Summit and Millennium

According to its Form 394, Millennium is a privately held company, formed for the purpose of developing and operating cable television systems. Millennium states that its long term strategy is to become a superior provider of very high quality entertainment video, high speed data and other telecommunications services on a single-source basis, primarily to residential customers. Thus far, Millennium has acquired one other cable system: a former Intermedia system that competes directly against Jones Intercable Inc., and serves approximately 53,000 subscribers in suburban Baltimore.

Millennium represents that at the system (local) level, its management is committed to providing customer services representatives with the proper tools they need to service customers in an increasingly competitive environment. Local management will have responsibility for all day-to-day operations and will be empowered to make quick decisions to ensure that operations continue to run smoothly. Following consummation of this transaction, the Company expects to retain most of Summit's current management team to operate the property. Accordingly, Millennium states that with the exception of an eventual name change, this transaction will be virtually transparent to the franchising authority, as well as customers, with normal system operations continuing.

Summit Communications, headquartered in Bellevue, provides cable services in the Central Cable Television Franchise District (Central District) pursuant to Seattle City Ordinance No. 118361 (passed on November 4, 1996) and in the TCI-1 Franchise District pursuant to Ordinance No. 117955 (passed on December 18, 1995). The company also serves parts of the downtown area through street use permits, under SMC 21.60.700. Summit serves approximately 13,000 Seattle subscribers, and offers approximately 70 television channels in the TCI-1 area and 55 channels in the Central Area. Pursuant to provisions in the 1996 Telecommunications Act governing small cable systems, Summit's rates are not regulated.

Summit is Seattle's only franchised cable provider in the Central District. Under the terms of its Central District franchise, the company is obliged to rebuild its cable system to 750 MHz capability by December 2001. Summit is overbuilding the TCI-1 Franchise District, providing cable and other services in competition with the existing provider, TCI. System construction in this area is brand new, and is to 750 MHz capability. Under the TCI-1 franchise, Summit is obliged to build out the area, so that at the end of the franchise period, all area subscribers will have access to Summit's services (in addition to TCI's).

III. Scope of the Review

With the Summit acquisition, Millennium is purchasing an established company with experienced management, and franchise obligations and commitments already in place. These commitments include the rebuild and buildout obligations discussed above, as well as system upgrade requirements, programming and customer service requirements, and development of enhanced services including high speed Internet access. We therefore focus this review on Millennium's economic viability, executive experience, and willingness and ability to meet and exceed the requirements set forth in Summit's franchise agreements.

Documents relied up to evaluate the Summit-Millennium transfer include:

- The FCC's Form 394. The FCC requires cable companies seeking franchise transfers to file an FCC Form 394 with local regulators` (where local rules require franchise authority consent). The Form 394 discloses information about past adverse findings, financial qualifications, technical qualifications, and the transferee's background, experience and character. A copy of Summit's Form 394 is set forth as Exhibit B.

- Summit's Annual Report. Pursuant to its Seattle franchises, Summit files a consolidated annual report, addressing issues such as compliance with the franchise agreement, subscriber rates, channel changes, buildout and rebuild progress, customer service standards, and system compliance with technical specifications.

- Financial and economic data and projections, and other specific information provided in response to correspondence generated by the Office of Cable Communications.

- Telephone interviews with executives from Summit and Millennium, and with the Cable Administrator for Anne Arundel County, Maryland, where Millennium purchased an established cable system earlier this year.

IV. Analysis of the Transfer of Control

A. Millennium's Ability to Show Financial Responsibility

1. Sources of Financing

Millennium has secured both debt and equity financing to complete this transaction. Equity financing comes from a private investment group called TSG Capital Fund III, LP (TSG). TSG will make available approximately $31 Million in connection with the Summit acquisition (in addition to $41 Million already made available for the Intermedia acquisition in suburban Baltimore). Millennium represents that the majority of TSG's available funds come from public pension investments, including the California and Washington state employee retirement funds.

Debt financing comes from a consortium of banks led by Fleet National Bank. Millennium has arranged a credit facility of approximately $135 Million ($77 Million of which was borrowed in connection with the Intermedia acquisition), and expects to use about $41 Million in connection with the Summit acquisition. Millennium also plans to use $12 Million over the next couple of years for planned capital expenditures such as plant and equipment upgrades.

2. Economic Analysis

Our Office has retained KFA Services to prepare an economic analysis of Millennium's financial qualifications to run the Summit operation. That analysis is set forth as Exhibit C. From his review of the data obtained, Mike Katz, KFA Services' principal, makes several observations that are summarized below.

- Millennium's financial projections, although optimistic, indicate that the Summit system, or the combined Summit-suburban Baltimore systems, plus money available from the credit facility, should generate sufficient cash to meet Millennium's franchise obligations.

- It should be noted that Millennium is a new company and has no operating or financial history of its own.

- Millennium's projections are based in part on anticipated growth of subscriber numbers, and in revenues per subscribers. Millennium's projections are more optimistic than Summit's history with respect to revenue per subscriber and operating margins. However, they are not out of line with what other cable operators have achieved, and may reflect Millennium's commitment to add Internet and digital services, intended to make cable services more attractive to non-subscribers, and to generate increased revenue per subscriber.

- Growth in per subscriber revenues could also come from increases in basic cable rates. Pursuant to federal regulations, basic cable rates for small cable operators (as Millennium will be even after the Summit acquisition) are not regulated.

- Millennium's planned expenditures in the next two years to upgrade Summit plant and equipment will approximately double Summit's capital expenditures for the past two years.

- The primary financial negative to this transaction is the increased debt that the Millennium entity will have versus Summit's existing debt. However, there is no reason, at this time, to believe that Millennium will not be able to manage its debt.

Based on the foregoing, and the more detailed discussion of these issues set forth in the KFA Services analysis, our Office expects that Millennium will remain a financially viable entity, and recommends that the Council not disapprove this transfer for economic reasons.

B. Ability and Willingness To Meet Existing Franchise Conditions.

With respect to the Millennium's ability to manage a cable operation, we note Millennium's stated plan to retain substantially all of Summit's current management team. This includes the current Sr. Vice President and Chief Operating Officer, the VP-Engineering, and the directors of the High Speed Data Services Division and New Technologies Division.

In response to our inquiry about Millennium's commitment to existing franchise terms and conditions and plans for system upgrades, Millennium's CEO stated:

> In connection with the requested franchise transfer approval, Millennium Systems is not seeking any modification of the existing franchise terms. It intends to fully comply with all franchise provisions and to meet or exceed all applicable federal state, and local operation requirements, including those relating to the rebuild and buildout requirements, customer service standards, PEG obligations and the system's technical standards. Following the acquisition of the system, the Company intends to compete a comprehensive survey of equipment, service offerings and plant condition and focus on ways to improve operations and increase customer satisfaction.

> Following consummation of this transaction, the Company expects to retain the current local management group to operate this property. Accordingly, from an operating and relationship perspective , this transaction should be virtually transparent to the City of Seattle and its residents, with normal operations continuing. Letter, Kelvin Westbrook to Steve Holmes, October 12, 1998.

Finally, although Millennium is a new company, its principals appear to have substantial cable television experience. Chuck Payer, Millennium's Board Chairman, has 28 years' experience in the telecommunications industry, including executive and management positions with Southwestern Bell and Western Electric (now Lucent Technologies) among others. Kelvin Westbrook, Millennium's CEO, was a principal in Charter Communications beginning with that entity's first entry into cable television systems and continuing for many years. The experience and qualifications of other Millennium principals are set forth in detail in the Form 394.

V. Conditions

Although we ultimately recommend approval of the transfer, there are several issues of concern. We believe that these are adequately addressed by conditions in the transfer ordinance (referred to you under separate cover), to which Millennium must agree before the transfer becomes final. Millennium has indicated that it will agree to these conditions.

First, Millennium is essentially a start up company, with no track record beyond its current purchase of a well managed cable system. Any start up operation presents some level of risk beyond that of an existing operation with a defined track record. Moreover, Millennium appears to be pursuing a strategy of purchasing discrete systems, as opposed to clustered systems, and benefits from economies of scale are not readily apparent. Therefore, we recommend and provide in the transfer ordinance for full commitment by Millennium's principals to the obligations set forth in Summit's franchise agreements.

Second, under SMC 21.60, the Council must consider the benefits of local ownership. This transaction involves the sale of a locally owned enterprise to a company headquartered in St. Louis. We include language in the transfer ordinance that requires maintenance of management positions and support staff necessary to fulfill the continuing obligations set forth in the franchise agreements.

Third, the issue of open access to the cable system by unaffiliated on-line and Internet service providers is presently receiving considerable national and local attention. At this point, Summit states that customers will be able to choose ISPs and on-line providers that are unaffiliated with the company, on terms and conditions comparable to Summit's affiliated ISP. Because regulatory developments are changing rapidly, however, our Office believes that the City should protect its ability to intercede in this area, if prudent public policy and the governing laws and regulations permit. We have included language in the transfer ordinance that specifically allows the City to reopen the franchise for renegotiation if Millennium restricts access to unaffiliated on-line or Internet service providers.

Finally our Office recommends language in the transfer ordinance that specifically binds the new entities, Millennium and LP, to the commitments in Summit's franchise agreements, that establishes Millennium's responsibility for franchise non-compliance,

and that voids the transfer in the event that the purchase and sale is not completed. We believe that Millennium's consent to these commitments, provided in writing within thirty days after the ordinance has been signed by the Mayor, gives reasonable assurances that the franchise requirements and obligations will be followed.

VI. Conclusion

Millennium is a new enterprise established for the purpose of acquiring cable properties. Its principals' apparent intent is to generate new revenue through the introduction of new services such as digital television and high speed Internet access. Millennium appears to have sufficient financial resources to complete the transaction and to make the investments necessary to ensure compliance with the rebuild, upgrade and other requirements of Summit's franchise agreements. Current plans call for maintenance of Summit's current management team; moreover, the Millennium principals have considerable experience in cable television industry, and projections and expectations for the Summit system that, while optimistic, are not out of line with what other cable operators have been able to achieve.

The transfer ordinance commits Millennium to the obligations established under Summit's franchise agreements, and addresses issues such as preservation of local management and access to Internet services as well. The Cable Office recommends that the Council pass the transfer ordinance, and permit the Summit acquisition to go forward under the conditions established therein.

cc: Dwight Dively
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Steve Weed, Summit Communications, Inc.