

PROPOSAL FOR
MARKETING AND WHOLESALE ACCESS PROGRAMS
TO PROMOTE PUBLIC/PRIVATE
TELECOMMUNICATIONS INITIATIVES
FOR GAINESVILLE

Report to the
Gainesville Regional Utilities Committee
Updated December 20, 2000

SUMMARY

Staff's proposal to add Web Site Hosting to GRUCom's product line has resulted in an extensive and meaningful dialog with potentially affected local businesses. As a result, GRUCom is proposing four steps to align its interests more closely with those of local businesses. These are:

1. Agree to not design or engage in the creation of Web sites except for the clearly intended use of the City of Gainesville as related to its own products and services;
2. Establish an "Authorized Sales Representative" program that provides bonuses to businesses promoting GRUCom's services;
3. Establish a "Wholesale Services" program to provide participating resale businesses with wholesale discounts together with access to GRUCom's systems, including residential and commercial broadband access; and
4. Provide contractual and policy protection from predatory commercial practices.

The dialog included challenges to the very existence and purpose of GRUCom. Accordingly, the above proposals were developed within the context of the changing telecommunications industry and GRU's strategic plans to prepare for deregulation of the electric industry. A summary of these considerations and more information about GRUCom's proposals are included in this report.

BACKGROUND AND STRATEGIC IMPORTANCE

Gainesville Regional Utilities' (GRU) long-term strategic plan to prepare for eventual restructuring of the electric industry has been actively developed since 1989. Public discussions have been held in the form of workshops, budget hearings, and with the City Commission's Energy Advisory Committee. The key elements of this plan are to align the interests of the key stakeholders, improve profitability of GRU's current product lines, retain existing customers, and diversify revenue sources. GRUCom was formed as an independent enterprise under the System's Bond Resolution to support these overall objectives.

As deregulation approaches for the electric utility industry, a key competitive point of difference for GRU will be its diverse services. This provides convenience in addition to dependability to its customers. GRU's long term marketing plan is to build on this position to develop brand recognition and multiple relationships with each customer. The increasing importance of the Internet in daily life, the prevalent use of data networks among businesses, the emergence of e-commerce, and the fact that telecommunications is the single largest growing sector of America's economy makes GRUCom an important part of the plan.

The federal Telecommunications Act of 1996 explicitly allowed local governments to participate in the deregulated telecommunications industry. The importance of communications services to the prosperity of electric utilities is further supported by the fact that nearly every major investor-owned electric utility has developed, or is in the process of developing, a telecommunications line of business. Municipal utilities have followed suit. The American Public Power Association (APPA) has documented 116 municipal electric utilities that have launched telecommunication initiatives, including leasing dark fiber, switched services, data transport, retail Internet services and cable television. The four investor owned utilities in Florida; Florida Power and Light, Florida Power Corp, Gulf Power (through Southern Company), and Tampa Electric each have a strong market position in this industry. Municipalities including Ocala, Lakeland, JEA, Orlando, Kissimee, and Leesburg are also involved in telecommunications.

GRUCom's HISTORY

Even before GRUCom was created, GRU operated one of the largest communications enterprises in the area. For many years GRU has operated the City's data networks and telecommunications and radio systems to support its public safety and utility operations. In the early 1990's the Federal Communications Commission (FCC) mandated that GRU migrate off its wireless microwave frequency network used for supervisory control and data acquisition at substations. It thus became necessary for GRU to build a backbone fiber optic network to cost effectively connect its various facilities. The network was built in a partnership with Shands Hospital to connect the hospital with its outlying clinics. Shands' participation further improved the economics of the backbone fiber network. As construction of the fiber optic network began it became abundantly clear that the network could provide substantial additional benefits for the community.

In 1994, an employee team was created to research issues and identify how the City's investment in the fiber optic network could be leveraged to provide additional services to benefit the community. An important contributor to the team's efforts was Dr. Grant Thrall at the University of Florida. Dr. Thrall prepared an analysis that clearly indicated that Gainesville was a third tier communications services market and that a higher level

of communications services would aid the University of Florida in becoming a world-class institution and facilitate economic development in the area.

The team's recommendations resulted in the creation of GRUCom by the Gainesville City Commission in 1995. Another important aspect of the team's recommendations was to establish separation between GRU's enterprise activities and those involved in the City's role of regulating other telecommunications market entrants. The 1996 Telecommunications Act provided guidance for this separation.

GRUCom has already provided several benefits for the community. To name a few:

1. Facilitated the expansion of local Cellular and PCS services;
2. Opened City of Gainesville tower sites for co-location;
3. Assisted UF in increasing Internet connectivity (to dual DS-3's from a single T-1);
4. Implemented affordable Ethernet for wide area networks;
5. Created a local network access point (NAP);
6. Increased the data and information connectivity between Gainesville and the world;
7. Initiated ring-protected fiber optic services not available previously;
8. Improved connectivity for the public schools and libraries;
9. Assisted schools and libraries in obtaining federal e-rate funding;
10. Improved local Internet access capabilities (dual DS-3s's).

In addition to offering a range of services that were either previously not available or had very limited availability, GRUCom has played a major role in lowering prices for communications services overall.

GRUCom's MISSION

GRUCom's Mission Statement, adopted in 1995, operates within the context of GRU's overall business objective, which is to *"Increase net revenues over the long term by optimizing market share"*. The GRUCom Mission Statement reads as follows:

"Provide information infrastructure and integrated, low cost data communication services to the Gainesville Urban Area in such a manner as to minimize duplication of facilities, maximize inter-connectivity, simplify access, and promote the evolution of new technologies and business opportunities".

A key consideration at that time was to avoid proliferation of telecommunications and cable lines, and communications towers in the community. GRUCom achieved this by offering integrated transport services on the fiber optic network instead of dark fiber, by opening access to many utility facilities and sites for wireless co-location, and by providing interconnectivity with other carriers and the Internet. GRUCom's local Internet

network access point (NAP) is still the only way to exchange Internet traffic locally without having to make expensive router hops out to Internet nodes in first tier Cities.

GRUCom will accomplish its mission by balancing the expansion of products and services with revenue generation. Delivering diverse services over common infrastructure will be a key ingredient of success. GRUCom may eventually offer voice and video services in addition to the data and Internet services that constitute today's offerings.

GRUCom's current and potential product lines are summarized below. Those product lines and specific products that are under consideration for the future are shown in **Bold**.

1. Data Transport (DS-1, DS-3, OC-1, OC-3, OC-12, OC-48, 10Mbps Ethernet, **100 Mbps Ethernet, Gigabit Ethernet**);
2. Dedicated Internet Access (Fractional T-1 up to DS-3);
3. Dial-up Internet Access (56k, ISDN);
4. Broad Band Internet Access (Ethernet, **DSL, Wireless**);
5. Local Exchange of Internet Traffic (NAP);
6. Tower Space Leasing (Antenna);
7. Public Safety Trunking Radio Services (Voice, **Data**);
8. **Web Site Hosting**;
9. **Carrier Access Co-location**;
10. **Switched Local Exchange Telecommunications Services**;
11. **Long Distance Telecommunications Services**;
12. **Video Services**.

The major product lines listed above (items 8 – 12) have been discussed publicly with the Gainesville City Commission, with the understanding that staff would come back to the Commission with specific proposals when and if GRUCom was ready to begin offering services in a new product line. Staff's proposal to offer Web Site hosting at this time is only one of a number of proposals staff expects to submit to the Commission in the future. This specific proposal has resulted in the current dialog with concerned local businesses. It seems clear, however, that the debate is related to the specific product offering being proposed by staff but is actually a more philosophical debate. The question Should a government entity be engaged in a specific enterprise activity and/or to what extent?

SITUATIONAL ANALYSIS

Staff's Position

GRU has unique advantages in bringing communication services to the local community. These include: excellent credit ratings; industry acknowledged legal, technical and operational depth; brand identity and customer access; bulk purchasing capability; and

extensive billing and support systems. As a consequence, GRUCom has established a strong market presence in Gainesville for data transport services, data networks, dedicated Internet access services, dial up Internet access services, voice and data wireless services, and tower space leasing. GRUCom is well positioned to expand services in the future consistent with its mission.

It is important to point out, however, that GRUCom does not have several advantages which are often attributed to it by others including: tax-exempt financing; special rights to access rights of way; and freedom from property taxes (although the legal authority to impose property taxes on municipal telecommunications infrastructure is currently being challenged).

Concerned Local Business Position

Concerned businesses that have spoken out to date include the local CATV providers and a small number of local Internet Service Providers (ISP's), fiber construction contractors, Web site developers, and telephone equipment providers. These businesses have expressed a concern that GRUCom's advantages, real or perceived, will create unfair and damaging competition for them. Accordingly, a variety of arguments have been presented to protest the emergence of GRUCom as a competitor. The focus of these protests vary. They range from "eliminate GRUCom altogether" to requiring that GRUCom only provide wholesale products and services that local businesses could bundle with other value added services to resell at retail.

MUTUAL INTERESTS

The concept of developing a mutually beneficial alliance between GRUCom and local business interests emerged during an independently facilitated workshop held on November 16, 2000. The results of this meeting are documented in Reference 1. The workshop was structured to elicit only the interests of the concerned local businesses present. Staff's mission was to attempt to take the interests of the local businesses expressed during this workshop and develop a business model for GRUCom products and services that took these concerns into consideration.

Summary of Local Business Interests

1. Access to transport service alternatives.
2. Lower prices for transport and dedicated Internet services.
3. Broadband access to residential and small commercial customers.
4. No risk of losing customers to transport service providers.
5. Access to GRUCom's cost and operational advantages.
6. Knowing GRUCom's boundaries and rules.
7. Enforcement of GRUCom's boundaries and rules.

8. Elimination of unfair competition.
9. Earning profits on investments.

GRUCom's Interests

1. Providing local government, businesses and residents with transport service alternatives to BellSouth.
2. Building stronger loyalty and satisfaction with present and future GRU customers.
3. Building positive brand recognition with customers.
4. Promoting environmentally sensitive economic development opportunities.
5. Increasing traffic on the network infrastructure.
6. Increasing the number of connections to the network.
7. Promoting increased use of Internet technology.
8. Earning reasonable returns on previous and future investments to support the City's delivery of community services.

TELECOMMUNICATIONS TRENDS

The changing structure of the Internet is driving staff's recommendation to add Web Site hosting to GRUCom's product line at this time. This changing structure has resulted in GRUCom receiving several requests from dedicated Internet access service customers to host their Web sites.

Data and Internet use will continue to grow as e-commerce and use of the Internet for communication, advertising, and consumer services become more prevalent. The next new wave of demand will be for broadband Internet access for homes and small businesses. Provided that the appropriate broadband access infrastructure is put into place, conventional switched telephony and CATV will be supplanted by Internet and data transport technologies (i.e. IP telephony, streaming video, high definition television, video-on-demand).

These trends are very important for local businesses involved in communications. The construction costs for broadband access facilities are far higher than small entrepreneurs can bear. Many ISP's were able to enter the market initially by buying some modems and leasing a few phone lines. However, low bandwidth delivery will not be adequate in the future and these small businesses will not survive unless there is an open access platform available for their use. At the same time there will be new opportunity areas. The emerging new communication modalities will create unprecedented new demands for content creation and programming which are perfect for small business development.

The prevailing model of the Internet connecting widespread users to centralized servers is changing because of the inherent limitations of the Internet related to traffic constraints, and the adverse effects of numerous router hops on broadband applications. These effects

are much less noticeable at conventional dial-up service speeds. Nationally targeted Internet services need adequate facilities with very large connections to the Internet backbone to support distributed servers. GRUCom is presently the only local alternative access and local exchange carrier with adequate facilities, and a major node on the Internet, currently positioned to provide this level of service.

STAFF PROPOSALS

Staff is proposing four steps to align its interests more closely with those of local businesses. These are:

1. Agree to not design or engage in the creation of Web sites except for the clearly intended use of the City of Gainesville as related to its own products and services;
2. Establish an "Authorized Sales Representative (ASR)" program that provides bonuses to businesses promoting GRUCom's services;
3. Establish a "Wholesale Services" program to provide participating resale businesses with wholesale discounts together with access to GRUCom's systems, including residential and commercial broadband access; and
4. Provide contractual and policy protection from predatory commercial practices.

Proposal #1 – Web Site Design Business Restriction.

It has been said many times at City Commission meetings, "never say never" regarding future GRU products and services. Communications businesses are being continuously transformed by technological change and the boundaries between voice, data and video services are blurring. All larger communication services providers are striving to become full service providers. No one can accurately predict what products GRUCom will need to offer in the future to be successful. However, local ISP's have become increasingly concerned that the initiation of Web hosting services by GRUCom will lead to Web design. This has been characterized as a "slippery slope" problem related to GRUCom business expansion. While there is some disagreement among the staff regarding the advisability of placing any restrictions on GRUCom product and services expansion, there is general consensus that GRUCom will probably not be seriously harmed if Web Design services are not provided. Web design requires significant staff resources to develop creative content and GRUCom's strengths are more consistent with the construction, operation and maintenance of communications infrastructure.

Accordingly, staff offers the following statement of clarification, as being consistent with the Mission and long-term viability of GRUCom:

"GRUCom will not design or engage in the creation of Web sites, advertising copy, or other program creation except for the clearly intended use of the City of Gainesville as related to describing, promoting, and managing its own products and services."

Proposal #2 – GRUCom Authorized Sales Representative (ASR) Program

Staff recognizes that to ensure GRUCom's success, a significant and increasing amount of time and effort will need to be directed to marketing and sales. Most large communications companies rely not only on their own personnel to sell their products but also on a network of ASR's. The creation of a GRUCom ASR program could be beneficial to GRUCom while at the same time allowing smaller local businesses an opportunity to share in GRUCom's success.

The development of an effective program will take time. The program will need to be continually expanded as GRUCom adds new products and services and it will require continued administration. Staff intends to initiate discussions with potential ASR's to assist in the development of the program.

Although the parameters of the program will be open for discussion, it is anticipated that ASR's will receive either a commission or one time bonus payment related to sales that they complete on GRUCom's behalf. It will be necessary for participants in the program to qualify as an ASR and to sign a GRUCom ASR agreement (pending). GRUCom ASR's will need to be extremely ethical and capable of representing GRU before the general public.

Proposal #3 – GRUCom Wholesale Services Program

In addition to ASR programs, many network service providers also offer services at a discount to other carriers. GRUCom already offers discounts to the major carriers using GRUCom facilities for the local loop (AT&T, MCI Worldcom, Interstate FiberNet, and ITC DeltaCom). Staff proposes to implement a Wholesale Services program that will extend price breaks to other resellers, including ISP's. This will allow resellers to bundle GRUCom products with their own for maximum profitability. If the program is structured properly it should also improve GRUCom revenues, since the reduced price should be offset by increased sales volume. However, the rate design will need to carefully consider the fair market price for services and the cost to provide the service. Some form of recognition of GRUCom is desired for branding purposes, and could have the benefit of firmly aligning both parties' interests.

Participating resellers will need to provide GRUCom with a resale certificate related to the wholesale services they are purchasing. Services purchased for resale have certain tax implications that GRUCom must adhere to. The resellers will also be required to execute a Master Wholesale Services Agreement which will be the foundation under which they can order individual services on an as needed basis. Resellers may also be required to provide GRUCom with Deposits or Letters of Credit to guarantee payment on their account. GRUCom has experienced significant problems in the past with certain ISP customers that have been delinquent in their payments. A number of these smaller

businesses are thinly financed and businesses may be dissolved without the ability to payoff outstanding contractual obligations.

As with the ASR program, the Wholesale Services program will require time to develop and will need continual review and expansion. Potential program participants will be asked to provide input related to the design of the program.

Proposal #4 - PROTECTION FROM PREDATORY PRACTICES

Certain ISP's have indicated that they believe GRUCom has engaged in predatory practices, in effect, stealing customers. Staff specifically denies such allegations. Frequently, communications services customers will shop several sources, including GRUCom, before making a purchase decision. Providing a service proposal to a potential customer is not a predatory practice.

However, staff believes the process now used to order transport services from GRUCom could be improved to avoid any potential for future misunderstandings. While specific knowledge about delivery locations is beneficial to planning service delivery, Staff does not necessarily need to know the identity or service location of an ISP's potential customer until after the ISP has entered into a binding contract with the customer. ISP's participating in the Wholesale Services program will be provided with a GRUCom transport service pricing schedule and service availability information. With this information an ISP can be assured that they can obtain transport service from GRUCom at the prices indicated.

To further strengthen GRUCom's commitment to ethical business practices, GRUCom will also adopt the following administrative policy:

"When a carrier, ISP, or communications service provider presents GRUCom with a valid contract with a customer for a specific service, GRUCom will not provide a replacement service to that customer during the term of the contract."

REFERENCES

1. Martin, Charles, Ph.D. Report on Meeting of Local Business Owners at Gainesville Regional Utilities on Thursday, November 16, 2000. Prepared for Gainesville Regional Utilities Strategic Planning Department, 11/30/00.

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