

PROGRAM REVIEW AND INVESTIGATIONS COMMITTEE

Minutes 2018 Interim

September 13, 2018

Call to Order and Roll Call

The Program Review and Investigations Committee met on Thursday, September 13, 2018, at 10:00 AM, in Room 131 of the Capitol Annex. Representative Lynn Bechler, Chair, called the meeting to order; Senator Carroll led the audience in prayer and the Pledge of Allegiance; and the secretary called the roll.

Present were:

Members: Senator Danny Carroll, Co-Chair; Representative Lynn Bechler, Co-Chair; Senators Tom Buford, Perry B. Clark, Dan "Malano" Seum, Reginald Thomas, and Stephen West; Representatives Chris Fugate, Adam Koenig, Steve Riley, Rob Rothenburger, Arnold Simpson, and Walker Thomas.

Guests: Secretary William M. Landrum III, and Pamela Trautner, Director of Communications, Finance and Administration Cabinet.

LRC Staff: Greg Hager, Committee Staff Administrator; Chris Hall, Colleen Kennedy; Van Knowles; Jeremy Skinner; William Spears; Shane Stevens; Susannah Stitzer; Joel Thomas; Richard Schufelt, Graduate Fellow; and Kate Talley, Committee Assistant.

Minutes for August 9, 2018

Upon motion by Representative Rothenburger and second by Representative Fugate, the minutes for the August 9, 2018, meeting were approved by voice vote without objection.

Presentation on Contracting Policies and Procedures for Public Private Partnerships and Capital Projects Similar to KentuckyWired

Secretary Landrum, who is the chief purchasing officer for Kentucky, described the four contracting methods under the Kentucky Model Procurement Code. The KentuckyWired project falls under competitive negotiation. Proposals deemed responsive to the RFP are evaluated, scored, and ranked by scorers. Technical advisors are also involved in this step in the process. Negotiations then begin with the highest ranking vendor. If negotiations break down, an option is to proceed with negotiations with the second highest ranking vendor. Once there is agreement, a contract is eventually awarded.

For KentuckyWired, the first step was a request for proposal (RFP) on December 18, 2018 for a consultant to help with a request for information (RFI).

Representative Bechler noted that the committee requested a number of people involved in awarding the contract to attend today's meeting. Only two attorneys who are now in Washington DC agreed to attend.

In response to questions from Senator Carroll, Mr. Landrum said an RFI is the main process for those representing the state to gain information on how best to proceed. All potential vendors are welcome to respond.

In response to a question from Representative Rothenburger, Mr. Landrum said only personal service contracts are reviewed by the Government Contract Review Committee. He described the process.

Mr. Landrum said that an RFP for a private sector concessionaire partner was issued on July 11, 2014, based on information gathered through the RFI. Five scorers and five technical advisors were involved in evaluating the four vendors deemed responsive. The contract was awarded to Macquarie Infrastructure Development LLC on December 22, 2014, without negotiations having been completed. At this stage, there were jumping off points that would have required Kentucky to pay \$8 million to \$9 million should negotiations have broken down. Because the contract was awarded before negotiations were finished, allocation of risk moved heavily toward the state. Budget and timeline were the driving forces that led to the contract being awarded before negotiations were completed.

The environment affecting the project included the need to fill service gaps. Also, moving to a new network allowed funds that were being paid to providers to be used as a funding stream. This includes federal E-rate funds paid to school districts. In July 2014, the Federal Communications Commission (FCC) had ruled that the E-rate program could be used for dark fiber. The Finance and Administration Cabinet (FAC) proceeded as if the contract with Macquarie met the FCC's competitive bid requirements to access E-rate funds. Approving the procurement before the previous administration left was also a factor.

In order to use E-rate funds, the FCC advised that there should be a separate competitive RFP and a separate entity to manage KentuckyWired. The Kentucky Communications Network Authority (KCNA) was created by executive order in August 2015. The Kentucky Information Highway, version 4 (KI4) procurement was must win to guarantee \$11 million in E-rate revenue as a funding source. The KCNA executive director, who was the former deputy secretary of FAC, was a participant in selling the \$289 million in bonds for the KentuckyWired project through FAC and in the preparation of the KI4 RFP through KCNA. AT&T filed a protest on November 6, 2015. The KI4 RFP was canceled and not reissued.

Between the driving forces of the timeline and budget, project risks became apparent. Kentucky needed Competitive Local Exchange Carrier (CLEC) status to negotiate pole attachments. There were no pole attachment agreements with AT&T, Windstream, or any of the other 70-plus utility providers across the state. Nearly 45,000 property easements needed to be processed. Unfunded items such as site preparation, road relocation, getting commercial power to communication huts and nodes, and system refreshes at 10 and 20 years needed to be worked out. These project risks caused direct project claims, which are outside of project funding.

Public-private partnership (P3) legislation took effect on April 8, 2016, 2 years after the KentuckyWired RFP. Under the legislation, an agency establishing a P3 must conduct a qualitative and quantitative analysis that covers risk controls and efficiency of delivery, leverage private sector partner expertise, and allocate risk to and return on investment for private partners. The RFP must include methods of oversight the agency will use; responsibilities of the agency; plans for financing and operating the project; needed revenue, service payments, bond financing, and appropriations; and considerations resulting from the qualitative and quantitative analysis. Currently, universities have the only P3 projects in Kentucky.

In response to questions from Representative Bechler, Mr. Landrum said he is unaware of any other contracts that have been awarded before negotiations were finalized. The KentuckyWired contract was an anomaly due to its time and budget constraints. Pole attachments with AT&T and Windstream and easement agreements became immediate supervening events because they were not negotiated prior to the award of the contract. Before accepting responsibility, FAC investigates each supervening event to determine if it could have been mitigated or solved by the private vendor. Mr. Landrum said he is not sure of the CLEC process, but Kentucky not being a CLEC caused a delay.

In response to questions from Senator West, Mr. Landrum said he has never awarded a contract prior to negotiations being completed. Awarding the KentuckyWired project prior to negotiations being completed put the state at a disadvantage. Doing the project in stages would have been better. AT&T protested the KIH4 RFP because it knew the former FAC deputy secretary was involved in the bond sale and preparation of the RFP, and then became the director of KCNA, which was a bidder for the RFP. The RFP was a must win for Kentucky to secure E-rate revenue as a funding source for KentuckyWired.

In response to a request from Senator West, Mr. Landrum said that he could provide a list of the attorneys who represented Macquarie.

In response to questions from Representative Koenig, Mr. Landrum said that whether a project is bonded all at once or in parts depends on the situation. In any case, a

request must be made to the General Assembly every 2 years for appropriations for debt service. The KentuckyWired project has greatly energized the private sector. Some local governments are also improving broadband access. The intent of the KentuckyWired project was for state and local agencies to pay for access to the middle mile. Changes in the RFP process for P3s are not necessary because guidelines and regulations are already in place.

In response to a question from Senator Thomas, Mr. Landrum said that the state had assumed that the initial bid was sufficient for E-rate funding. The FCC said that this did not meet the competitive bid requirement for E-rate, so there would have to be a separate bidding process.

In response to a question from Senator Thomas, Mr. Landrum said that it could cost up to \$475 million to complete the KentuckyWired project

In response to questions from Senator Carroll, Mr. Landrum said that the way the original contract was competitively bid was within the scope of how procurement should proceed. During the process, decisions were not always wise given the constraints. The lack of expertise was not the problem. The primary issue was the timeline, which meant that the process was rushed. E-rate funding was not known and pole agreements were not in place. Senator Carroll said that under the contract, contractors can be rewarded for not performing in a timely fashion. Mr. Landrum said there was widespread involvement of agencies in the process, which included the Kentucky Department of Education regarding E-rate funds. The FAC secretary would have made the final decision to sign the contract.

In response to a question from Senator Carroll, Mr. Landrum replied that he had not reviewed the other proposals submitted for KentuckyWired. It is not normal to put all the risk on the state. Sometimes, the state buys insurance to mitigate risk. The FAC Office of Financial Management handles bond issues. He did not know if the E-rate problem was known at the time the bonds were issued. The state was counting on a \$28 million funding stream. The state has authority to move public sector entities to KentuckyWired, but the project is about providing the middle mile and is not trying to compete with the private sector.

Mr. Landrum said there is a need to move forward. The driving factors of funding and time led to decisions that put Kentucky at risk. Some of the issues that became supervening events could have been handled before the signing of the master agreement. The process took 8 or 9 months; it normally takes about a year and half.

In response to questions from Representative Simpson, Mr. Landrum confirmed that Kentucky was under no financial obligation prior to the execution of the contract in December 2014. FAC is still negotiating pole attachments; this responsibility could have been placed on the vendor during the negotiating process.

In response to questions from Senator Seum, Mr. Landrum said bond funds are drawn down as needed and Kentucky does have oversight as the money is drawn down. The KentuckyWired Infrastructure Company was set up to sell bonds and the KentuckyWired Operations Company was set up to manage the project and provide oversight of the operation. Easements are individually negotiated and then funds are drawn down. Responsibilities were not well defined during negotiations.

In response to questions from Representative Rothenburger, Mr. Landrum said Kentucky did not terminate the contract because there was a need for the project. The turning point regarding risk management was when authority was given to sell the bonds. At the time, there was no immediate call date on the bonds.

In response to questions from senator West, Mr. Landrum said invoices for attorneys from Baller, Stokes, & Lide PC and Polsinelli Law Group for approximately \$800,000 were approved by the FAC Office of General Counsel. He did not know if the attorneys advised on project risks.

In response to questions from Representative Bechler, Mr. Landrum said his predecessor was responsible for deciding whether to sell the bonds. KCNA may be able to explain why the FCC determined that the competitive process for E-rate funding was insufficient.

In response to questions from Senator Carroll, Mr. Landrum said he could provide the names of the five scorers and five technical advisors for the RFP. P3 projects need to continue to move forward once begun. After bonds were sold, there was no avenue for punitive action or termination.

Senator Carroll commented that the need for the project was evident. Many in the private sector are filling the voids for internet access. Mr. Landrum said the project accelerated the private sector's efforts across the state.

The meeting was adjourned at 11:51.