



Office of Auditor Mike Harmon



SPECIAL EXAMINATION

KentuckyWired

KENTUCKY COMMUNICATIONS NETWORK AUTHORITY

Program Review and Investigations Committee

October 11, 2018

Impetus and Timeframe

- ▶ Began in January 2018 after APA exercised right of first refusal in response to Finance Cabinet notification.
- ▶ Report released September 27, 2018.



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KentuckyWired Project Background

- ▶ Project announced in 2014.
- ▶ 2014 Budget Bill (House Bill 235) appropriated \$30 million state funding.
- ▶ Additional \$23.5 million anticipated federal funding via Appalachian Regional Commission.



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State Commitment

- ▶ Revenues cannot be estimated without rates, subscribers, and most importantly an operational network.
- ▶ Nearly \$1.5 billion cost over thirty years. Figure may increase due to:
 - ▶ Additional supervening event claims
 - ▶ Cost and frequency of network refreshes
 - ▶ Unresolved liability related to easements

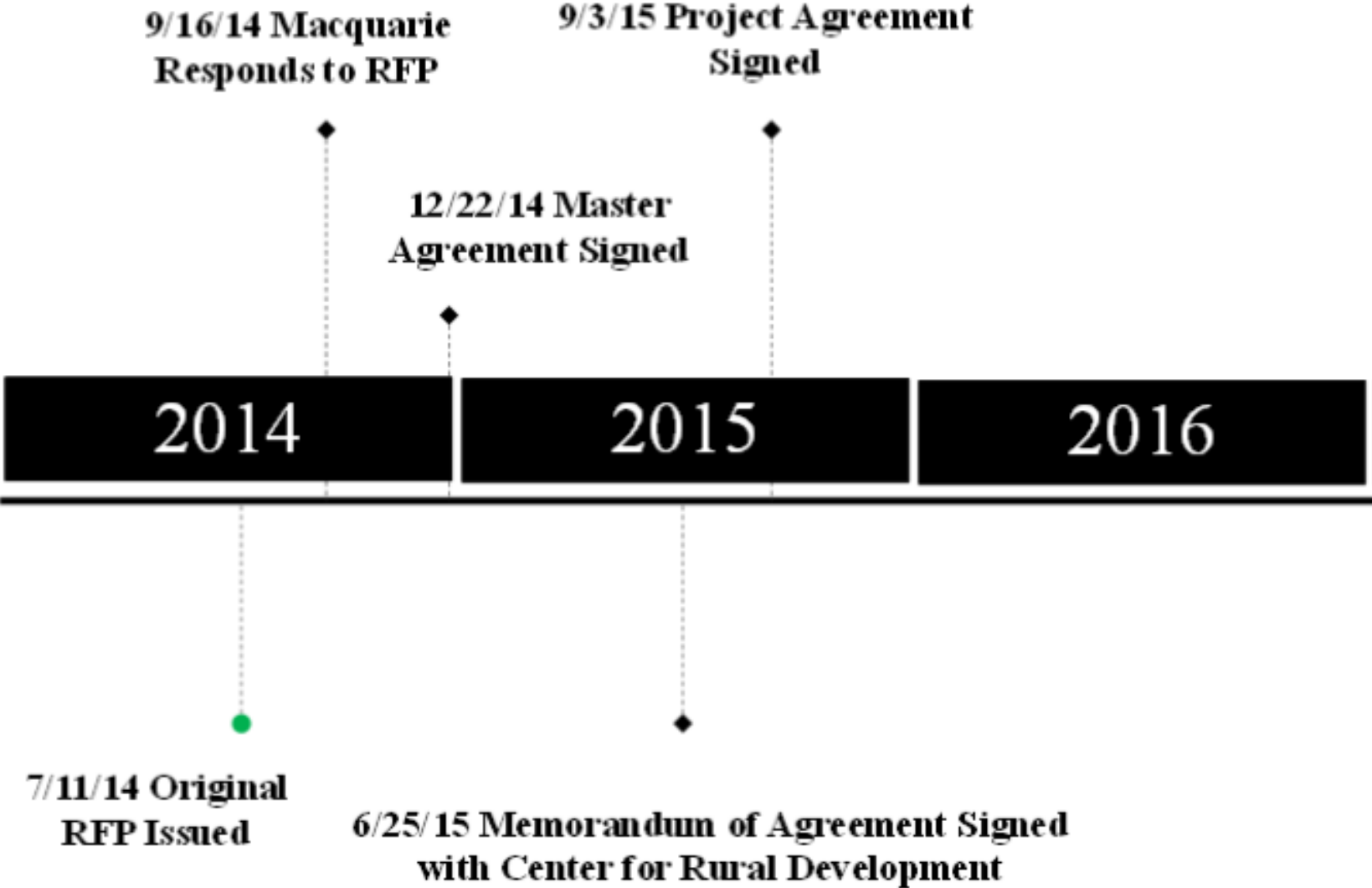


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Procurement Timeline



Procurement

Pole Attachments and Easements

- ▶ RFP section 10.H.: “Access to rights of way, easements, conduit access, pole attachments and regulatory compliance shall be the responsibility of the vendor.”
- ▶ Vendors have submitted 42 claims related to pole attachments, totaling \$9.7 million.
- ▶ Vendors have submitted 1 claim related to easements for \$24.6 million.



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Procurement Financing

- ▶ Vendor proposed fully funding with private capital, non-taxpayer debt, with no recourse to the Commonwealth.
- ▶ Financing was removed as a vendor responsibility one day before the Project Agreement was signed.
- ▶ Private equity now represents just over 1% of project costs.



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Procurement

Other Significant Changes

- ▶ Un-Availability Payments. We have been paying for infrastructure that is not operational.
- ▶ Fixed-price, date certain concept did not materialize as proposed.
- ▶ Risks shifted to Commonwealth minimize private sector incentives.



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Warnings regarding K-12 Revenue

- ▶ KDE officials warned the former FAC Secretary that KentuckyWired would not be E-rate eligible.
- ▶ Project funding relies on transferring government internet services to KentuckyWired.
- ▶ The majority of K-12 internet services are reimbursed through federal E-rate program if competitively bid, along with other requirements.



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K-12 Revenue Stream

- ▶ FAC proceeded with the project agreement and RFP despite the written warning from KDE.
- ▶ RFP was withdrawn after protests based on alleged conflict of interest.
- ▶ 45% of the anticipated funding stream for KentuckyWired was to come from K-12 school internet services.

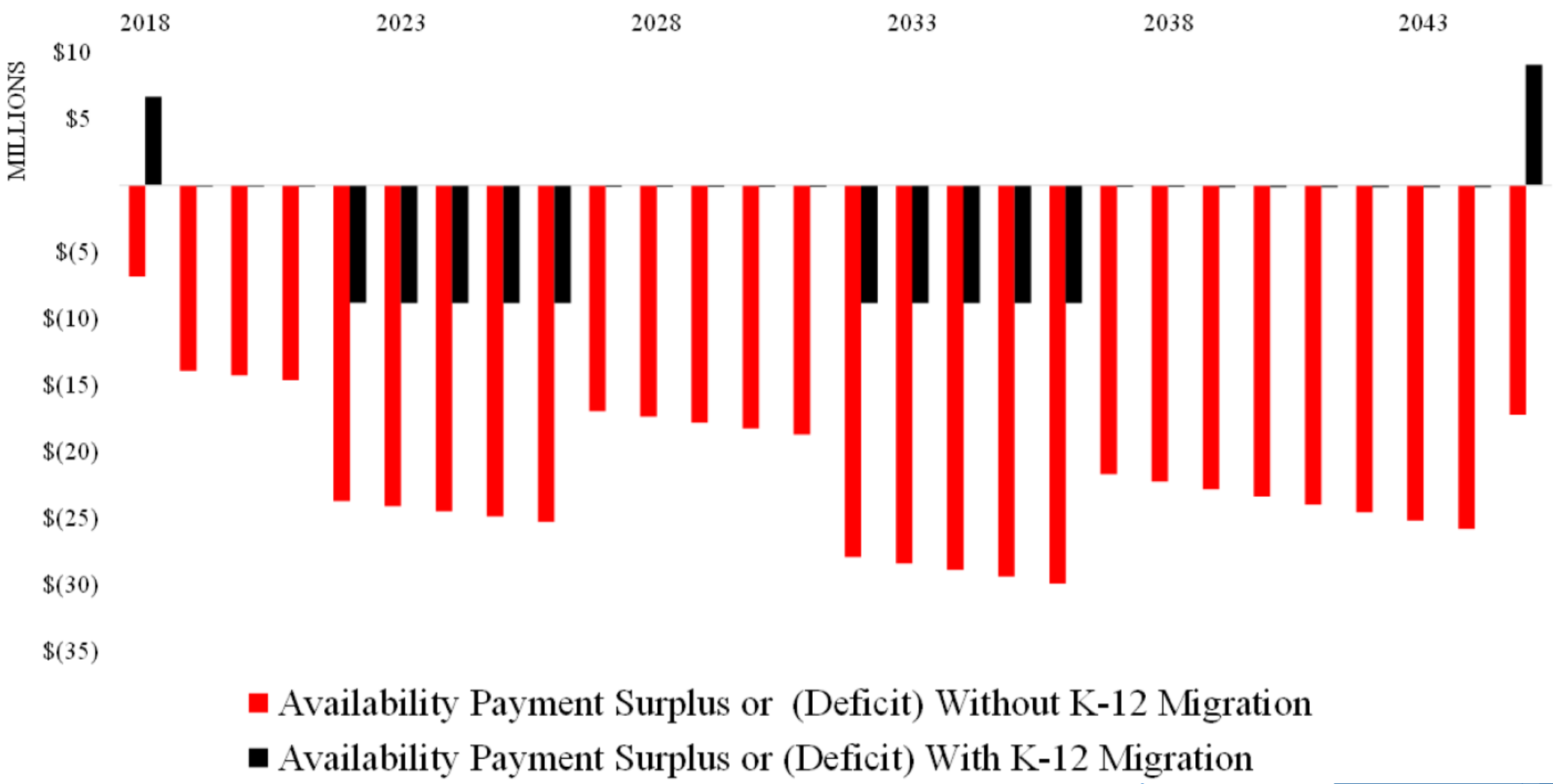


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K-12 Funding Gap



Pole Attachments

- ▶ A contractor warned state officials that pole attachment problems could cause them to miss deadlines.
- ▶ Planners estimated needing 5,000 poles owned by AT&T, when in reality they needed nearly 12,000.
- ▶ Planners estimated needing 750 poles owned by Windstream, when in reality they needed nearly 8,000.



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Pole Attachments

- ▶ KCNA told auditors that private vendors were responsible for pole counts, not the Commonwealth.
- ▶ The Project Agreement states that “[KWIC] and [the Commonwealth] have undertaken commercially reasonable efforts to confirm the number of poles owned or managed by the Pole Providers.”



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Tentative \$88 Million Settlement

- ▶ Details are still being negotiated past the agreed upon initial deadline of July 6, 2018.
- ▶ \$24.6 million in contractor claims related to easements are not resolved by the settlement.
- ▶ Future supervening event claims during construction and operation are not resolved by the settlement.



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Wholesale Revenues

- ▶ Government sites are one part of revenue planned from KentuckyWired.
- ▶ 45% of this revenue is not available (K-12), and the rest is not available until a network is operational.
- ▶ Additional revenue is expected from wholesaling excess network capacity.



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Wholesale Revenue

- ▶ Model is “conceptual” according to vendors.
- ▶ Revenue plan builds in 2.5% price increases every year of network operation.
- ▶ Optimistic revenue projections of \$1.3 billion to the Commonwealth over thirty years.



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Wholesale Revenue Projections

- ▶ Revenue projections are not guaranteed and specifically disclaimed.
- ▶ Investment to generate wholesale business is discretionary with private vendors based on profitability.
- ▶ If not profitable, “economic development initiatives” may be undertaken at additional cost to the Commonwealth.
- ▶ The wholesale revenue will be shared with The Center for Rural Development, Inc.



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Use of Wholesale Revenues for Unplanned & Additional Costs

- ▶ Minimum of two network refreshes estimated cost totaling \$87 million.
- ▶ K-12 funding gap: \$539 million.
- ▶ Settlement debt and reserve for additional supervening events totaling \$110 million (does not include interest on this debt).
- ▶ Possible liability related to easement claims of \$24.6 million.
- ▶ Possible economic development initiatives.



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Continued Examination of Procurement

- ▶ More information led to more questions during the examination.
- ▶ Who authorized significant changes to original terms of the RFP and vendor response that placed 93 percent of the financial burden on the Commonwealth?



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Questions?

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