

PROGRAM REVIEW AND INVESTIGATIONS COMMITTEE

Minutes 2018 Interim

October 11, 2018

Call to Order and Roll Call

The Program Review and Investigations Committee met on Thursday, October 11, 2018, at 10:00 AM, in Room 131 of the Capitol Annex. Senator Danny Carroll, Chair, called the meeting to order, led the audience in a 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, Wil Schroder, Dan "Malano" Seum, Reginald Thomas, and Stephen West; Representatives Chris Fugate, Adam Koenig, Steve Riley, Rob Rothenburger, Arnold Simpson, and Walker Thomas.

Guests: Greg Hale, CEO/Manager, Logan Telephone Company; Tyler Campbell, Executive Director, Kentucky Telecom Association; Linda S. Vandeloop, Assistant Vice President, External Affairs, AT&T; Mike Harmon, Auditor of Public Accounts, Chris Hunt, General Counsel/Executive Director of Office of Technology & Special Audits, Josh Winfrey, Audit Manager, Auditor of Public Accounts; and Phillip Brown, Executive Director, Kentucky Communications Network Authority.

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

Minutes for September 13, 2018

Upon motion by Representative Riley and second by Representative Simpson, the minutes for September 13, 2018, meeting were approved by voice vote without objection.

Telemarketing, Disclosure of Cellphone Numbers, Misidentification of Callers

Ms. Vandeloop said that in July 2016, the AT&T chairman agreed to chair a robocall strike force at the request of the Federal Communications Commission (FCC) chair. The members of the group developed a plan and a more robust set of mitigation tools. The plan focuses on consumer choice, detection, assessment, trace back, caller identification authentication, and regulatory support from the FCC. There is no way to block all robocallers. Spoofing is only illegal if done with the intent to commit fraud. Illegal spoofers spoof a trusted number or a number that appears as local to the person being called.

The industry has developed standards for caller identification referred to as shake and stir. The standards are being implemented. By May 2019, the government structure should be in place. Some companies have committed to signing their calls by next year. Eventually, consumers may see a checkmark that the call has been authenticated. This may stop spoofing but it will not stop robocalls.

Many carriers in the industry have created a group to trace sources of robocalls. AT&T has several tools available to consumers. The company blocks calls it identifies as illegal, subject to FCC rules. AT&T also does consumer education and provides a link to which people can report robocalls.

Mr. Campbell said the Kentucky Telecom Association (KTA) has 18 member companies, which include rural telecom cooperatives, small commercial telecom companies and two regional wireless providers. KTA members serve 45 counties, predominantly rural areas.

The FCC receives about 200,000 complaints per year about robocalling or similar types of calls. In September, the FCC issued two fines totaling over \$119 million for illegally spoofed calls. It has made new rules allowing phone companies to block types of calls that are likely to be unlawful before they reach consumers. Many phone companies are providing these robocall blocking features. KTA's national association, NTCA-The Rural Broadband Association, has engaged with the FCC and the Federal Trade Commission (FTC) to address this issue. The key to combatting and reducing the number of unwanted robocalls is continued advancement of technology applications and consumer education.

It is a misconception that robocallers and telemarketers obtain individual wireline and wireless numbers from telecommunications companies. Guidelines in FCC regulations prohibit selling information such as when a customer places a call, the person called, the location from where the call is placed, and the telephone services to which the customer subscribes. It is not in the best interest of companies to upset their customers, so they make every effort to protect their customers' privacy. Autodialers allow robocallers to dial multiple random numbers in a specified area code and exchange prefix. A number of carriers are deploying robocall blocking technology. There are hundreds of third-party blocking apps. Mr. Campbell concluded by listing 11 things that consumers should do to reduce unwanted calls and protect themselves from fraud.

In response to questions from Senator Carroll, Mr. Campbell said voicemail can be accessed from spoofed calls. Mr. Hale said default passwords on technological devices should be changed. Spoofers can use legitimate software to manipulate data to show a preferred number when calling.

In response to questions from Representative Bechler, Ms. Vandeloop said examples of legitimate spoofing would be when a doctor calls from a personal device, but the office number is shown as the source of the call, or when a call is made from a battered women's shelter. Most legitimate spoofing is done for safety reasons. Mr. Hale said many government agencies legitimately spoof calls to show the main department number rather than a direct line. Spoofing is illegal in the US unless certain criteria are met. Ms. Vandeloop said the AT&T antispoofing application only works on phones with an AT&T account. Mr. Campbell said several third-party applications will work regardless of the carrier. Ms. Vandeloop said people using landline phones can register online with Nomorobo to block spoofing calls. AT&T created a landline phone that will intercept any call not in its directory. Mr. Hale said many carriers use databases to block calls. Mr. Campbell said he will provide a list of local companies in KTA.

Certain Contracts, Operations, and Activities of the Kentucky Communications Network Authority

Auditor Harmon said that the Auditor of Public Accounts' (APA) examination of KentuckyWired began in January 2018. The findings, released in September, were referred to the Executive Branch Ethics Commission. The APA is continuing its examination of the procurement related to this project. He provided background information on the KentuckyWired project. Most funding was supposed to come from the private sector, but this has not been the case in practice.

It is not possible to determine the net cost of the project. Revenues cannot be estimated because rates, the number of subscribers, and if and when the network becomes operational are unknown. It is known that officials in the prior administration signed an agreement committing the state to nearly \$1.5 billion in costs over 30 years. Due to several factors, this is a conservative estimate.

He summarized the procurement timeline. Two major changes during procurement have led to problems. First, in the initial request for proposals (RFP), the private sector was responsible for easements and pole agreements. In the master agreement, the state was responsible for them. Second, Macquarie's response to the RFP indicated that the project would be fully funded by private capital with no debt financed by taxpayers and with no recourse to the state. One day before the project agreement was signed, financing was removed as a responsibility of the private sector. Currently, private equity is approximately 1 percent of project financing. The financing arrangement also ties Kentucky's credit rating to this project.

There is evidence that some of the problems could have been avoided. Kentucky Department of Education officials warned the Finance and Administration Cabinet secretary that KentuckyWired would not be E-rate eligible. Forty-five percent of the anticipated revenue for KentuckyWired was to come from providing internet service to K-12 schools.

A contractor warned state officials that pole attachment problems could cause deadlines to be missed. Claims related to pole attachment agreements are part of the \$88 million settlement memorandum Kentucky signed this year. The settlement does not cover the nearly \$25 million in contractor claims related to easements.

The revenue projections for KentuckyWired assume that the price for wholesale service increases 2.5 percent per year. The auditor's report considers the estimated revenue projection of \$1.3 billion over 30 years to be optimistic for several reasons. Wholesale revenue that does materialize must be shared with the Center for Rural Development.

The key question is who authorized the significant changes to the original terms of the RFP that placed 93 percent of the financial burden on the state with no legislative input.

In response to questions from Senator Carroll, Mr. Harmon said the Commonwealth changed financing for the project because it was believed that buying tax-exempt bonds would save money. Mr. Hunt said these negotiations resulted in establishing the Kentucky Wired Infrastructure Company (KWIC), which transferred much of the risk to the Commonwealth. The procurement process for the KentuckyWired project was unusual. It was done as a Public-Private-Partnership (P3) before P3 legislation was enacted. Mr. Harmon said bids may have been different if the change in financing had been known to other vendors. Mr. Hunt said there is a separate revenue sharing memorandum of agreement between the state and the Center for Rural Development. The auditor's office cannot say how binding the memorandum is.

In response to questions from Representative Rothenburger, Mr. Harmon said the recent P3 legislation has safeguards in place to limit any one person from having the authority to place the state in so much debt. This project would have had more oversight from the General Assembly had the Capital Projects and Bond Oversight Committee meeting not been canceled prior to the sale of the bonds. [Note: In the meeting, it was stated that a Government Contract Review meeting that would have considered KentuckyWired was canceled. LRC staff have confirmed that it was a meeting of the Capital Projects and Bond Oversight Committee that was canceled, which is reflected in the minutes.]

In response to questions from Senator Seum, Mr. Harmon said the auditor's report found that additional oversight and monitoring of the Kentucky Communications Network Authority (KCNA) is needed. Mr. Hunt said the missing money mentioned in the report refers to the loss of the K-12 funding. The original proposal stated that the Commonwealth would not pay for the project until it was completed, accepted, and ready. However, a stream of payments are being made rather than milestone payments—even without a completed network.

In response to questions from Senator West, Mr. Hunt said they spoke to internal attorneys who represented the Commonwealth, but not those who worked outside of state government due to attorney-client privilege. KCNA did not provide some documents, claiming attorney-client privilege. Senator West said the Commonwealth is the client and a malpractice suit may need to be filed to obtain the rights to see the documentation for the project. Mr. Hunt said that Macquarie is the primary vendor and brokered to bring other entities into the project. Those entities worked directly for Macquarie. The Commonwealth paid these entities to advise Macquarie and draw up contracts. These contracts appeared to be favorable to Macquarie. Mr. Harmon said he had never heard of a government contract being issued before negotiations were completed.

Representative Bechler said Western Kentucky often gets overlooked in terms of revenue sharing. He also stated he does not believe that attorney-client privilege should not apply since there was not an individual client and that the Commonwealth should pursue action to retrieve the information.

In response to questions from Representative Bechler, Mr. Hunt said statute allows the Capital Projects and Bond Oversight Committee co-chairs to cancel a meeting. Mr. Harmon said the project settlement estimates that the project will be completed in 2020; however, that settlement has not been finalized. Before those negotiations, contractors estimated 2022. Mr. Hunt said further supervening events will push back any projected timeline. He did not know when the state would start making money, but there will be no revenue until the system becomes operational. The conservative cost projection is \$1.5 billion. Mr. Harmon said the state does not have a full obligation to make availability payments if the General Assembly stops funding them; however, we have a moral obligation so as not to affect the state's bond rating. If the new settlement agreement is not signed, a new RFP could be issued.

Representative Bechler said the entire project should be stopped and the state should deal with any lawsuits that are filed to prevent additional debt.

In response to questions from Representative Koenig, Mr. Harmon said there was a \$2 million good-faith payment during settlement agreement negotiations. Mr. Hunt said the portions of the network that have been completed cannot be brought online until an entire ring is operational. KCNA may be able to comment on the construction status of the project. Mr. Winfrey said Macquarie has a relationship with the wholesaler but is no longer part of the construction on the project. Mr. Hunt said Macquarie is no longer doing business in Kentucky. Mr. Harmon said as APA continues to review the procurement phase of the project, it could be discovered that Macquarie could not raise the necessary funding. Mr. Harmon said it is difficult to determine what the value of the project infrastructure will be.

Representative Koenig would like someone to try to determine the value of the infrastructure once the project is complete. He said there seem to be three options that led

to the current status of the project: gross incompetence, a complete disregard for taxpayers, or something nefarious.

In response to questions from Senator Carroll, Mr. Brown said KCNA is preparing a response to the auditor's report. None of the reported problems are surprises. Completed sections of the network cannot be lit until the Commonwealth Data Center in Frankfort is connected. Some portions may be able to be brought online without the entire ring being completed, but there will not be any redundancy. None of the sites have redundancy at this time.

In response to questions from Senator Thomas, Mr. Harmon said that it is difficult to estimate what the completed project will cost. Current supervening events, not including easements, are still being settled. Availability payments are included in the cost and several other items are not quantified. Mr. Harmon said not making bond payments is an option, but is not a good idea as it would hurt the state's bond rating.

In response to questions from Senator Buford, Mr. Harmon said the state's debt service for the bonds would be several hundred million dollars if the project is shut down. If the project is shut down without going live, it would save approximately \$1 billion.

In response to questions from Senator West, Mr. Winfrey said Macquarie is part owner of the project operations company. Mr. Hunt used a chart to show that Macquarie is not part of the construction and operation. KWIC, a Commonwealth-created entity, and KentuckyWired Operations Company (KWOC), a Macquarie affiliated company, are now in charge of those areas. Mr. Winfrey said all private partners in the project have put in \$4.2 million in equity. Mr. Harmon said that from a government standpoint, an example of a good P3 is the Indiana Toll Road project. Mr. Brown said the repayment of the private-partner equity contribution is part of the availability payment schedule. He said he will send an explanation of KWOC's equity owners and its breakdown to committee staff. KWIC transferred all its responsibilities to KWOC through the project agreement to build and maintain the network. KWOC then transferred its construction responsibility to the Next Generation Kentucky Information Highway. KWOC transferred its service responsibility for the maintenance of the network for 30 years to another entity called the service provider. However, these transfers of responsibilities do not relieve KWOC or its owners of the responsibility to build the network for Kentucky.

In response to questions from Representative Simpson, Senator Carroll said the contract for the project was scheduled to go before the Capital Projects and Bond Oversight Committee, but the meeting was canceled. Perhaps in the future a contract should be required to go through committee before being awarded. Mr. Harmon said the General Assembly should have some final approval as well, especially on a contract of this magnitude. The current P3 legislation requires that projects over \$25 million be approved by the General Assembly, but this legislation does not go into effect until 2020. Mr. Hunt

said he would have to review whether the Commonwealth has provisions in the project agreement regarding private partners assigning responsibilities to other entities.

Representative Simpson said buffers need to be created to protect taxpayers so they will not bear the brunt of failed endeavors. P3s are good in theory but in many instances they are not fair transactions.

Representative Bechler clarified he is not in favor of not making bond payments. He also said he did not know of any financial institution that was given 10.2 percent interest as when this contract was awarded. Typically, if getting compounded interest, that interest is received at the end of the term. With the exception of paying the bonds, the project should be ended.

Senator Carroll said the auditor's report is available on the LRC website under the committee's meeting materials.

In response to a question from Representative Rothenburger, Senator Carroll said the staff report on surplus state property is ready. This and other reports will be presented at future meetings.

The meeting adjourned at 11:55.