THE BOARD OF THE KENTUCKY COMMUNICATIONS NETWORK AUTHORITY

MINUTES OF THE THIRD MEETING
JANUARY 28, 2016

Call to Order and Roll Call

A meeting of the board of the Kentucky Communications Network Authority ("Board" and "KCNA") was held on Thursday, January 28, 2016 at 11:00 a.m. EST in Room 110 of the Capitol. Secretary Scott Brinkman, Chair, called the meeting to order and the roll was called.

Present were:

Members: Scott Brinkman, Secretary of the Governor's Executive Cabinet and Chair of the Board; Jim Barnhart, Acting Chief Information Officer, Commonwealth Office of Technology; John Chilton, State Budget Director; Jeff DeRouen, Executive Director, Kentucky Public Service Commission; and Lonnie Lawson, President and CEO, The Center for Rural Development.

Guests: Adam Beam, Associated Press; Stephanie Bell, Public Service Commission; Robyn Bender; Will Calle; Tyler Campbell, Kentucky Telecom Association; Phillip Coleman, Kentucky Department of Education; David Couch, Kentucky Department of Education; Bill Estep, Lexington Herald Leader; Thomas Ferree; Doyle Frisnkey, Council on Post-Secondary Education; Allen Gillum, Appalachian Wireless; Nathan Haney, Office of the Governor; Mike Hayden, KCNA; John Hicks, Office of the State Budget Director; Patrick Hughes; Drew Jenkins; Karen Kelly, Office of Congressman Hal Rogers; Mike Lee, KentuckyWired Operations Company; Brent Legg; Janet Lile, KCNA; Eric Lycan; Brian Mefford; J.E.B. Pinney, Public Service Commission; Nancy Rodriguez; Jeanne Shearer; Danielle Smoot, Office of Congressman Hal Rogers; Hollie Spade, AT&T; Russ Woodward, Windstream Communications.

Secretary Brinkman verified that a quorum was present and that the press had been notified of the meeting. He welcomed all who were present and announced that the purpose of this meeting was to give background information to members of the new administration who are new to the Board and thus have not been previously involved with KCNA or the KentuckyWired project.

Announcements:
- Secretary Brinkman announced for the record that due to ongoing health issues, Steve Rucker, the Executive Director of KCNA, had tendered his resignation effective February 15, 2016. He asked that Mr. Rucker be remembered in everyone's thoughts and prayers.

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Status Report on KentuckyWired Project Buildout
Mike Hayden, Chief Operating Officer, KCNA

Due to illness, Mr. Rucker was not present to give the report, so Secretary Brinkman requested Mike Hayden, the Chief Operating Office of KCNA, to provide a status report on the KentuckyWired project in Mr. Rucker's stead.

Mr. Hayden began his report by providing a background of the project and noted that its purpose is to expand global internet capacity for both the state government and educational institutions. The project went into contract negotiations in mid-July 2015 and concluded with the bond sale in September, 2015. The funding sources for KentuckyWired include four series of bonds in the aggregate amount of $289,946,000 that have been issued by the Kentucky Economic Development Finance Authority (KEDFA), a $30 million allocation from the General Assembly, and $23.5 million in federal funds. Preliminary design engineering was begun last year and currently KCNA is assembling the permitting and pole agreements necessary to further the project. Node construction has begun on campuses, and the conduit structure is being evaluated. Right of way permits with the Department of Transportation (DOT) are also being signed.

Scheduling-wise Mr. Hayden informed the Board that ring one—Southeast Kentucky—and the "golden triangle"—Louisville, Lexington, and Northern Kentucky—are to be completed first. He noted that the reason why there is focus on urban regions is that it is critical for the project's success to bring Frankfort online concurrently with ring one. Fall of 2018 is the scheduled date for the full completion of the project and, according to Mr. Hayden, the project is still on schedule. Testing of individual rings will be completed by third-party vendors as the project completes each ring. Secretary Brinkman asked when the actual fiber was due to be laid. Mr. Hayden informed him that fiber laying will begin after the permits have been signed with the DOT. The fiber will begin in Lexington and then build out in four directions.

Secretary Brinkman then asked Mr. Hayden to give an expenditure accounting of the project. According to Mr. Hayden, roughly $93 million has already been spent on the project, but that was to be expected due to the number of up-front costs associated with the project. Currently, the project is on budget. Responding to a number of follow-up questions, Mr. Hayden also stated that there is some money built into the project's funding to deal with cost overruns, and there are sufficient funds available to complete the project at this time.

Director Chilton then asked Mr. Hayden about his background. Mr. Hayden commented that he spent thirty plus years working in sales and operations for telecom companies. He came on board as a Commonwealth employee two years ago as a Director of Communications for the Commonwealth Office of Technology (COT), running the state's wide-area networks, which is where he became involved in the planning for the KentuckyWired project. Steve Rucker asked him to come on board the KCNA shortly thereafter.

Secretary Brinkman asked if Mr. Rucker also came from COT. Mr. Barnhart noted that Mr. Rucker was actually CIO before moving to become Deputy Secretary of the Finance and Administration Cabinet.

Status Report on Existing Kentucky Information Highway 3 (KIH-3) Contract
David Couch, Kentucky K-12 CIO, Kentucky Department of Education

After Mr. Hayden's update, Secretary Brinkman asked David Couch, Chief Information Officer of the Kentucky Department of Education (KDE), to give an overview of K-12 locations regarding their use of internet and cloud-based services.

Mr. Couch first stated his qualifications and noted that he had actually given testimony about this subject to the Interim Joint Committee on Appropriations and Revenue on September 4, 2015. Mr. Couch then reported that the official stance of KDE is that KDE is in favor of bringing higher internet speeds to the underserved parts of the state. However, Kentucky is already a national leader in K-12 high speed internet access. In the early 1990's, Kentucky became the first state to bring high speed internet to every school. This past August Kentucky became the first state to achieve a national goal of 100 kb per student. The other key component is that student-teacher and school CIO satisfaction with the current system is at an all-time high.

According to Mr. Couch, KIH-3—the current version of the K-12 high speed network—is an E-rate eligible contract, which is important because it nets the state around $11 million annually in federal funds. KIH-3 is in the third year of a ten-year contact with AT&T and the network has been as stable and reliable as anything the state has ever experienced. Because of this, Mr. Couch shared that Kentucky K-12 would prefer to stay on its KIH-3 contract until KentuckyWired has been fully completed and been fully tested as reliable and financially efficient. He noted that this reliability was imperative given K-12's reliance on cloud-based services. Mr. Couch anticipates that KentuckyWired will take much longer to achieve this level of reliability than is currently planned. This would problematic for K-12 institutions that would have to pay additional costs for maintaining two separate networks during the transition.

Mr. Couch then reported that commonly held beliefs about high speed home access for Kentucky students are misguided. According to KDE's 2013 Digital Readiness Survey, about 90% of students or parents have high speed access in their homes. Even some of the poorer counties in Kentucky do have considerable access to high speed. Mr. Couch pointed to Owsley County— where every child has high speed access— as an example. Later on, Mr. Lawson commented that Owsley County was not necessarily an accurate representation of all of Eastern Kentucky in regard to high speed access.

Mr. Couch also announced that there are about $324 million in funds available through the federal Connect America program that could be used to help Kentucky improve home and business high-speed access. Secretary Brinkman asked whether anyone was accessing these

funds. Mr. Couch responded that he would have to contact individual entities that want the funding, but the funding has to be requested by the Commonwealth's vendor partners.

At this time Secretary Brinkman questioned how much KDE is spending on payments per year under the current KIH-3 contract. According to Mr. Couch, the number is about $13 million per year, $11 million of which KDE recoups through E-rate funding. He then noted that KentuckyWired, as currently structured, would not be E-rate eligible, because the E-rate eligible contract had not yet been competitively bid. Responding to a question from Director Chilton, Mr. Couch reported that to be eligible for E-rate funding, the funds must be used for K-12 schools or libraries, must be competitively bid, and must regularly go through E-rate audits.

Director Chilton then asked about the difference between first, middle and last mile as referred to in this project and whether Mr. Couch believed the KentuckyWired program to be better than KIH-3. Mr. Couch informed the Board that KDE pays for an internet link to each district office, called the district hub, which is done through the KIH-3 contract. Each district has a variety of ways to connect to that hub—some are close enough that they run a line of fiber themselves, while others use local providers. That connection is considered the last mile. The middle mile— which KCNA focuses on— is considered to be the physical link from the backbone network to that district hub. According to Mr. Couch, the reason you hear telecoms complain about this differentiation is that often times they consider that middle mile to be their last mile. As to Director Chilton's other question, Mr. Couch did not see KentuckyWired as an improvement over KIH-3, due mostly to the inexperience of both the prime and subcontractors involved on the project. Given these issues, Mr. Couch supports the continued use of KIH-3 and was also supportive of the cancellation of the KIH-4 solicitation.

Position of the Council on Post-Secondary Education Regarding KentuckyWired
Doyle Friskney, Chief Technology Officer, University of Kentucky

After Mr. Couch's status report, Secretary Brinkman asked Doyle Friskney, the Chief Technology Officer of the University of Kentucky, to provide his perspective of post-secondary institutions in regards to the KentuckyWired project.

Mr. Friskney began by stating that he was fully in favor of and excited by the prospect of the KentuckyWired project. Over his 30 year career, Mr. Friskney has watched post-secondary institutions undergo a significant shift in their use of access to internet resources. In the past, they have been constrained by bandwidth issues, simply because the only alternatives they have ever had were to outsource their technology to private entities. While the results were good—he pointed to KCTCS as a leader in this field—he became a proponent of systems like KentuckyWired about eight years ago after carriers refused to provide shovel ready projects to the universities, which would have allowed them to win Broadband Technology Opportunity Program (BTOP) funding. Because of this, Kentucky universities had to enter into "managed services contracts" with carriers that kept bandwidth control in the hands of the carriers.

Currently, Kentucky universities are more cloud based than they ever have been. Everything from e-mail to academic resources are provided in the cloud and so, according to Mr. Friskney, bandwidth needs have become a real issue for post-secondary institutions.

As to KentuckyWired, Mr. Friskney reported that it provides post-secondary institutions an opportunity to have a state infrastructure that will allow them to grow their bandwidth needs without significantly having to reinvest in infrastructure. Along those same lines, he pointed out the potential ability for a large university, like the University of Kentucky or the University Louisville, to reach out and provide service to small and mid-size hospitals, allowing them access to services they would never be able to acquire on their own.

Mr. Friskney projects that the KentuckyWired project will be able to meet the bandwidth needs of our state for at least the next ten years. If the KentuckyWired project were to be terminated for whatever reason, Mr. Friskney was absolutely confident that the state will pay equal money to someone else to provide those same services. According to Mr. Friskney, the KentuckyWired project offers post-secondary institutions the freedom to "change the model" for how internet services are procured on college campuses.

Secretary Brinkman asked how much CPE institutions pay each year for services and what kind of bid processes they had to follow. Mr. Friskney said that the number was about $4.5 million, which includes all public universities and KCTCS. Universities, however, do not have E-rate eligibility issues. Governor Bevin could direct the universities to transition to the KentuckyWired infrastructure once it becomes operational. Mr. Lawson pointed out that KCNA surveyed other states and concluded that Kentucky post-secondary institutions are paying up to six times more for internet service than other states. Mr. Friskney anticipates these costs increasing. Mr. Friskney also does not anticipate the reliability issues suggested by Mr. Couch.

Status Report on KentuckyWired Financing Agreements
John Hicks, Deputy State Budget Director, Office of the State Budget Director

Secretary Brinkman next requested John Hicks, the Deputy State Budget Director, to provide a status update of the financing agreements for KentuckyWired.

According to Mr. Hicks, the state spends about $30 million each year for network/internet services. He noted that the goal is for state institutions to transition to the KentuckyWired infrastructure once it becomes operational and to pay the operator of the KentuckyWired project for the network/internet services that the state is currently paying other entities. About $12 million of that funding represents K-12 public schools and about $4.5 million represents post-secondary institutions. State libraries are another potential source of funding for the KentuckyWired project. There is an effort underway to merge them into a consortium (similar to Kentucky's K-12 schools), so they could take advantage of the E-rate program as well.

According to Mr. Hicks, the payments referred to in the project agreement between the Commonwealth and the developer of the KentuckyWired project are referred to as availability payments, which is common in public-private partnerships. Mr. Hicks explained that the idea behind the KentuckyWired project is to take the annual state spending on network access and use those funds to make availability payments under the project agreement. The availability payments will eventually equal approximately $28.5 million per year under the project agreement. Under the project agreement, the developer of the project has assumed the risks associated with the cost to construct the project and the schedule of the build-out.

Mr. Hicks noted that the availability payments due under the project agreement are not flat over the entire 30-year term of the project agreement. About 60% of the $28.5 million in availability payments, referred to as the capital and financing tier, will escalate at 2.5% annually. The other approximately 40% portion of the availability payments, referred to as the operations and maintenance tier, is tied to the CPI for materials and the employment cost index for labor. The labor portion equates to 17% and the materials portion equates to 22%. According to Mr. Hicks this escalating cost feature is also typical of P3 contracts. Another feature of the project is that the system has to be re-tested every 10 years during the term of the project agreement. The Commonwealth retains the right to competitively bid out the re-testing services. Break-fix costs in the contract are fixed for the ten-year period.

After Mr. Hicks' remarks, Secretary Brinkman questioned the source of funding for the availability payments if the K-12 institutions did not migrate to the Kentucky-Wired project. Mr. Hicks responded that it would be difficult, but there is a yet to be negotiated wholesale agreement whereby the state could sell excess middle mile capacity that could potentially make up the loss of the K-12 funding. It is unclear, however, if there would be enough market interest to make up for the loss of the K-12 revenues. Sale of "indefeasible rights of use" to private interests or possible construction cost savings could also help make the availability payments or reduce overall costs of the project.

Status Report on the RFP Process for KIH-4
Secretary William Landrum III, Finance and Administration Cabinet, Secretary

Secretary Brinkman next requested William M. Landrum III, the Secretary of the Finance and Administration Cabinet, to provide an update on the KIH-4 solicitation process.

Secretary Landrum began by announcing that the purpose of his remarks is to provide the status of the KIH-4 Request For Proposal (RFP) process within the Finance and Administration Cabinet, including a recitation of the chronology of the RFP process and to answer the question of why he has not reissued the RFP for KIH-4. According to Secretary Landrum, in August 2015 KNCA was created by Executive Order. On September 3, 2015, operative agreements for the project were signed and on the same day KEDFA issued the bonds for the KentuckyWired project. As far as he knew, this closing was with the understanding by KEDFA and the General

Assembly that a competitively-bid KIH-4 contract for the K-12 schools would be in place to serve as a guaranteed source of repayment for the bonds.

Secretary Landrum has three primary concerns about the bond issuance. First, unlike what was planned, the bonds were issued without first conducting an E-rate eligible competitive bidding process or having a KIH-4 contract in place, thus putting Kentucky taxpayers on the hook for a portion of the availability payments that must be made in order to pay debt service on the bonds. Second, any future RFP for a KIH-4 contract would now be framed as a "must win" for the Commonwealth as the K-12 E-rate payments are necessary to make the availability payments to pay the debt service on the bonds. Third, the bond deal was closed while the Executive Director of KCNA—Steve Rucker—was serving as the Deputy Secretary of the Finance and Administration Cabinet, thus calling into question the fundamental fairness of the procurement process.

Secretary Landrum next reported that, at the meeting of the Interim Joint Committee on Appropriations and Revenue held on October 22, 2015, members of the Committee inquired about the KentuckyWired project and the impending solicitation process for the KIH-4 contract. Several members of the Committee expressed concern regarding the consequences if KCNA was not the successful bidder for the KIH-4 contract. Secretary Landrum noted that, on November 2, 2015, AT&T filed a protest in the RFP process for the KIH-4 contract based upon a number of points, including Mr. Rucker's involvement with both the drafting of the RFP for the KIH-4 contract and the consummation of the bond deal while serving as the Deputy Secretary in Finance and Administration Cabinet, and that the term of the current KIH-3 contract extends to 2023 if all renewal options are exercised by KDE. On November 30, 2015, the Finance and Administration Cabinet cancelled the KIH-4 solicitation and denied AT&T's protest as moot.

At this point Secretary Landrum reported that the KentuckyWired project was continuing to move forward with the cooperation of the Finance and Administration Cabinet. However, he commented that his responsibility as Secretary is to ensure that any future RFP issued with respect to the participation of K-12 in the KentuckyWired project is done in a competitive, E-rate eligible manner. The Secretary then discussed a number of possible scenarios for a re-solicitation of the KIH-4 contract. However, given the timing of the bond sale and the "must-win" situation for the Commonwealth, Secretary Landrum did not anticipate being able to resolicit a KIH-4 contract without the probability of protests being filed by other potential bidders or the possibility of litigation challenging the legitimacy of the solicitation process. According to Secretary Landrum, the financing plan for the KentuckyWired project assumed participation from a number of state agencies, including the K-12 schools, thus creating the availability payments to be made to the developer of the KentuckyWired project based upon the amounts that these institutions were currently paying for broadband services.
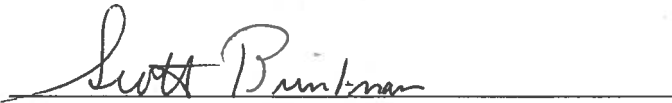
Secretary Brinkman commented that he needed more time to process this new information. It may be necessary to ask questions of the previous administration to understand why the bidding

was conducted in this way. Secretary Landrum responded that the E-rate eligible KIH-3 contract is currently in place, which means that the Board has time to evaluate the situation.

Secretary Brinkman then asked if there was any more business for consideration. Mr. DeRouen announced that this would be his last meeting as a member of the Board of KCNA.

There being no other business before the Board, Secretary Brinkman asked for a motion to adjourn. Mr. DeRouen motioned to adjourn. Director Chilton seconded the motion, and the meeting was adjourned unanimously at 12:31 p.m. EST.

Respectfully Submitted,

Secretary Scott Brinkman, Chair
Kentucky Communications Network Authority