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November 10, 2014

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RECEIVED

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PUBLIC SERVICE
COMMISSION

Jeff Derouen
Executive Director
Kentucky Public Service Commission
P.O. Box 615
211 Sower Boulevard
Frankfort, Kentucky 40601

Re: *Application of Windstream Kentucky East, LLC and Windstream Kentucky West, LLC (1) for a Declaratory Ruling that Approval is Not Required for the Transfer of a Portion of their Assets; (2) Alternatively for Approval of the Transfer of Assets; (3) for a Declaratory Ruling that Communications Sales and Leasing, Inc. is Not Subject to KRS 278.020(1); and (4) for All Other Required Approvals and Relief*, Case No. 2014-00283.

Dear Mr. Derouen:

Enclosed for filing please find an original and ten copies of the Rebuttal Testimony of Robert E. Gunderman on behalf of Windstream Kentucky East, LLC and Windstream Kentucky West, LLC. Copies have been mailed and provided via e-mail to counsel for the other parties of record.

Sincerely,

R. Benjamin Crittenden

RBC

COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter Of:

The Application Of Windstream Kentucky East, LLC And Windstream Kentucky West, LLC For (1) A Declaratory Ruling That Approval Is Not Required For The Transfer Of A Portion Of Their Assets; (2) Alternatively For Approval Of The Transfer Of Assets; (3) For A Declaratory Ruling That Communications Sales and Leasing, Inc. Is Not Subject To KRS 278.020(1); and (4) For All Other Required Approvals And Relief

CASE NO. 2014-00283

REBUTTAL TESTIMONY OF

ROBERT E. GUNDERMAN

ON BEHALF OF WINDSTREAM KENTUCKY EAST, LLC

AND WINDSTREAM KENTUCKY WEST, LLC

I. INTRODUCTION

Q. PLEASE STATE YOUR NAME, POSITION AND BUSINESS ADDRESS.

A. My name is Robert E. Gunderman. I am employed by Windstream Holdings, Inc. and my position is Interim Chief Financial Officer and Treasurer. My business address is 4001 Rodney Parham Road, Little Rock, Arkansas 72212.

Q. ARE YOU THE SAME ROBERT E. GUNDERMAN THAT FILED DIRECT TESTIMONY IN THIS PROCEEDING ON BEHALF OF WINDSTREAM KENTUCKY EAST, LLC AND WINDSTREAM KENTUCKY WEST, LLC?

A. Yes, I am.

II. PURPOSE OF TESTIMONY

Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY IN THIS PROCEEDING?

A. The purpose of my testimony is to address issues raised by the Communications Workers of America's witness, Randy Barber, concerning the financial impacts of the transaction at issue in this proceeding.

Q. ARE YOU SPONSORING ANY EXHIBITS?

A. Not at this time.

III. ISSUES RAISED IN THE DIRECT TESTIMONY OF RANDY BARBER

Q. ON PAGE 6 OF HIS DIRECT TESTIMONY, MR. BARBER STATES THAT THE SALES PRICE FOR THE TRANSACTION WILL BE APPROXIMATELY $3.2 BILLION ON A COMPANY-WIDE BASIS. DO YOU AGREE?

A. The transaction is a spin-off and therefore the owners (i.e. shareholders of Windstream) are the same both before and after the separation. As such, it is not appropriate to characterize the transaction as a sale. $3.2 billion represents the reduction of existing debt of Windstream.

Q. ON PAGE 7 OF HIS DIRECT TESTIMONY, MR. BARBER STATES THAT SUBSTITUTING THE LEASE OBLIGATION FOR INTEREST AND DEPRECIATION ASSOCIATED WITH OWNERSHIP OF THE SUBJECT ASSETS WILL RESULT IN REDUCED FREE CASH FLOW. DO YOU AGREE?

A. I agree. As illustrated on Schedule RB-1, Windstream will have modestly less free cash flow following the Transaction. However, it is important to note that Windstream will also have $3.2 billion in less debt as a result of the Transaction. Windstream is also reducing its dividend to ten cents in concert with the transaction. As a result of the debt reduction and dividend reduction, Windstream will have more capital available going forward. Additionally, Windstream can partner with CSL to expand or enhance the fiber distribution system instead of requiring Windstream cash flows to fund the investments. With CSL's expected low cost of capital, CSL will be an attractive alternative source of capital for funding investments.

Q. ON PAGE 8 OF HIS DIRECT TESTIMONY, MR. BARBER EXPRESSES CONCERN THAT BY SUBSTITUTING A DISCRETIONARY CASH OUTLAY (DIVIDENDS) FOR A NON-DISCRETIONARY CASH OUTLAY (LEASE PAYMENT) WINDSTREAM'S FLEXIBILITY TO RESPOND TO BUSINESS CONDITIONS WILL BE LIMITED GOING FORWARD. DO YOU AGREE?

A. Mr. Barber's concern appears to be based primarily upon his Exhibit RB-1, which represents Windstream's 2014 financial performance. Importantly, the lease payment, which is tax deductible for income tax purposes, did not create a cash benefit in 2014 due to accelerated depreciation deductions in the preceding years (referred to as bonus depreciation) which led to minimal cash tax payments in the 2014 fiscal year. Windstream expects to become a cash tax payer in future years. Mr. Barber shows a decline in free cash flow of $322 million ($830 million to $508 million) but this ignores the tax deductibility of the lease payment. The lease payment will generate a tax benefit of $247 million (or 38% effective tax rate related to the $650 million lease payment) so the expected loss of free cash would be substantially less in future periods going forward. In other words, the $650 million lease payment has a free cash flow impact of $403 million, due to its tax deductibility.

Mr. Barber's testimony also insufficiently accounts for the fact that Windstream's outstanding debt will be reduced by $3.2 billion. Finally, as described in my testimony above, CSL will also be a potential funding partner for future investments. The financial flexibility achieved through the combination of these actions, together with the planned changes in the dividend structure, provides a better platform for addressing the financial and capital needs today and in the future.

Q. ON PAGE 9 OF HIS DIRECT TESTIMONY, MR. BARBER STATES THAT HE CANNOT DETERMINE WHETHER THE TRANSACTION WILL INCREASE OR DECREASE NET CASH AVAILABLE TO THE OPERATING COMPANIES BECAUSE THAT WILL DEPEND ON INTEREST EXPENSE, DEPRECIATION EXPENSE, AND OTHER FACTORS FOR THE OPERATING COMPANIES BEFORE AND AFTER THE TRANSACTION. PLEASE EXPLAIN ANY

FINANCIAL CHANGES THE OPERTING COMPANIES WILL EXPERIENCE AS A RESULT OF THE TRANSACTION.

A. The Master Lease Agreement will be made between CSL and Windstream Holdings, Inc., and not directly with the Operating Companies. Both before and after the transaction, the Operating Companies will distribute their excess free cash flow to Windstream Holdings, Inc. for general corporate uses including principal and interest payments on debt, dividend distributions, and (following the transaction) payment of the rent on the lease.

Q. ON PAGE 9 OF HIS DIRECT TESTIMONY, MR. BARBER QUESTIONS THE PROPOSED ACCOUNTING TREATMENT FOR THE TRANSACTION. PLEASE ADDRESS THIS ISSUE.

A. The accounting treatment for the Transaction is consistent with how the assets will be distributed to CSL and leased back to Windstream. The accounting has been reviewed and approved by Windstream's external auditors, a nationally recognized accounting firm. Moreover, Windstream has reviewed and discussed the accounting treatment with the Securities and Exchange Commission ("SEC") and the SEC has not raised any concerns.

Q. ON PAGE 9 OF HIS DIRECT TESTIMONY, MR. BARBER RAISES OPERATIONAL CONCERNS FOR CWA MEMBERS, INCLUDING THEIR ABILITY TO ACCESS POLES AND CONDUITS FOLLOWING THE TRANSACTION. PLEASE ADDRESS MR. BARBER'S CONCERNS ON THIS ISSUE.

A. As explained in detailed in the Application and my direct testimony, after the transaction closes the Operating Companies will have long term, exclusive use of the Subject Assets, including all poles and conduits. The Operating Companies will continue to maintain and expand the network, and the personnel responsible for maintenance and expansion of the network prior to the Transaction will retain those responsibilities after the transaction closes. The Operating Companies' employees, including CWA members, will see no change in their ability to access poles, conduits or any other part of the network as a result of the Transaction.

Q. ON PAGE 10 OF HIS DIRECT TESTIMONY, MR. BARBER QUESTIONS WHETHER THE ACCOUNTING TREATMENT OF THE LEASE WILL IMPAIR WINDSTREAM'S ABILITY TO PAY DIVIDENDS, AFFECT COVENANT REQUIREMENTS ON DEBT, AND HAVE OTHER, UNIDENTIFIED FINANCIAL IMPLICATIONS. PLEASE ELABORATE ON THESE ISSUES.

A. The accounting treatment of the lease will not impair Windstream's ability to pay dividends. The dividends distributions are not limited by GAAP equity but rather the fair value of Windstream's equity. It is widely understood that GAAP or book value often does not equate to fair value. In the present case, this is evidenced by Windstream's equity market capitalization of approximately $6 billion on November 7, 2014. Moreover, GAAP equity has no bearing on the ability to issue equity in the future. The combination of lower debt and a more sustainable dividend level will improve Windstream's ability to raise both debt and equity capital in the future. Also, the accounting treatment will not impair Windstream's compliance with its debt covenants. Specifically, the accounting of the transaction as a long term lease obligation does not impair (or detriment) the covenant calculations given the characterization of the liability as long term lease obligation for GAAP. Also, Windstream Corporation's indentures do not require any consents to effect the Transaction.

Q. ON PAGE 10 OF HIS DIRECT TESTIMONY, MR. BARBER STATES THAT WINDSTREAM HAS NOT SHOWN HOW THE DIFFERENCE BETWEEN ITS BOOKS FOR TAX PURPOSES AND GAAP WILL AFFECT RATEMAKING. PLEASE ADDRESS THIS ISSUE.

A. As an initial matter, the Operating Companies made it clear in their Application and responses requests for information that the Transaction will not result in any rate changes. After the Transaction closes, the Operating Companies will continue to bill under the existing rates included in tariffs or contracts. Additionally, the Operating Companies have elected alternative regulation and their rates are not subject to rate-of-return regulation. Therefore, the Transaction will not have any impact on future ratemaking. With regard to pole attachment rates, as discussed in responses to information requests from the Commission Staff and the Kentucky Cable Telecommunications Association, the Operating Companies will continue to maintain all necessary information needed to support future rate changes in accordance with Commission orders.

Q. ON PAGE 10 OF HIS DIRECT TESTIMONY, MR. BARBER STATES THAT WINDSTREAM WILL BE REQUIRED TO TAKE A WRITE OFF REPRESENTING THE DISCOUNTED PRESENT VALUE OF THE LEASE PAYMENTS TO CSL, WHICH ALLEGEDLY WILL EFFECT WINDSTREAM'S SHAREHOLDER EQUITY OR ITS ABILITY TO RAISE CAPITAL IN THE FUTURE. PLEASE ADDRESS THIS CONCERN.

A. As set forth in my testimony above, the transaction significantly improves Windstream's ability to raise both debt and equity. The lease payments will result in a reduction of book equity under GAAP, but as discussed above, the ability to raise capital is not related to book equity. The ability to raise capital will be improved by this Transaction, because it significantly reduces long term debt and increases financial flexibility by reducing the dividend and creating the potential to source capital investment funds from CSL.

Q. ON PAGE 11 OF HIS DIRECT TESTIMONY, MR. BARBER STATES THAT A SEPTEMBER 12, 2014 LETTER FILED WITH THE PUBLIC UTILITIES COMMISSION OF OHIO MAKES IT UNCLEAR WHETHER LEASE PAYMENTS WILL BE DEDUCTIBLE FOR TAX PURPOSES. PLEASE ADDRESS THIS ISSUE.

A. The lease payments are deductible by Windstream for Federal Income Tax purposes.

Q. ON PAGE 11 OF HIS DIRECT TESTIMONY, MR. BARBER STATES THAT THE APPLICATION DOES NOT DISCUSS WHAT HAPPENS AT THE CONCLUSION OF THE LEASE. PLEASE ADDRESS THIS ISSUE.

A. I would first like to emphasize that the Lease has an initial term of 15 years, and up to four (4) renewal terms of five (5) years each, at Windstream's sole option (provided that there is no event of default), so that the Lease should remain in effect for a minimum of 35 years. At that point, Windstream and CSL could negotiate an extension or a replacement for the Lease, or they could allow it to expire. Of course, it is impossible to predict what technological and economic changes may have occurred by that time; it is at least theoretically possible that, by 2050, the Subject Assets could be considered obsolete and have little practical value. It is much more likely, however, that there will continue to be demand for some kind of telecommunications capabilities delivered to homes and businesses over fixed transmission facilities, as there has been since telephone technology was developed in the late 19th century, even though the nature of the facilities and the services they enable will probably continue to change.

Nevertheless, the Lease contains a transition provision under which, if the term does expire without a new agreement in place, the Operating Companies will continue to operate the Subject Assets on an interim basis until a new lessee has been identified, and until all regulatory approvals required under the laws in effect at that time have been obtained.

IV. CONLUSION

Q. PLEASE SUMMARIZE YOUR REBUTTAL TESTIMONY.

A. Through the Application and responses to requests for information issued by the Commission Staff and KCTA, the Operating Companies have provided the Commission with sufficient information determine that the Transaction will be beneficial to the Applicants and their customers. The Transaction will not result in any harm to Windstream's employees, including those who are members of the CWA. Accordingly, the Commission should grant Windstream's Application.

Q. DOES THIS CONCLUDE YOUR REBUTTAL TESTIMONY?

A. Yes, it does.