

COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

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In the Matter of:

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

**POST-HEARING BRIEF OF WINDSTREAM KENTUCKY EAST, LLC AND
WINDSTREAM KENTUCKY WEST, LLC**

Windstream Kentucky East, LLC and Windstream Kentucky West, LLC (collectively, “Operating Companies”) state for their post-hearing brief:

I. INTRODUCTION¹

The telecommunications industry continues to change dramatically and the Operating Companies exist in a highly competitive environment in which wireless, cable, and over-the-top VoIP providers continue to expand their telecommunications offerings.² To address this competitive landscape, the Operating Companies have transformed from primarily rural voice providers to advanced communications and technology services companies.³ Investments made by the Operating Companies have allowed them to remain competitive. This fact is made clear by Robert E. Gunderman in his testimony at the hearing conducted on November 13, 2014:

¹ A transcript of the hearing conducted on November 13, 2014 was prepared in accordance with the Commission’s Order of the same date granting the Operating Companies’ motion for a written transcript. The transcript is being filed in the record of this proceeding by the Operating Companies. Citations to the transcript are in the form of “T. at _____.”

² Direct Testimony of Robert E. Gunderman (“Gunderman Direct”) at 2-3.

³ *Id.* at 3.

[E]ven through it's an absolute reality that wire and telecommunications providers like ourselves have experienced some wireline access line losses through the wireless substitution and other things, and through cable competition, the investments that we've made in certain of these markets have made a difference, and they have . . . slowed the decline and have given us a chance to win back . . . customers and make for a stronger franchise.⁴

The Operating Companies recognize, based on their past and recent experience, that they will better be able to compete going forward if they make the necessary investments to provide enhanced and expanded service offerings to their customers.⁵ For that reason “more investment is required in certain of our markets to maintain our competitiveness and improve it.”⁶ After considering a number of different alternatives, Windstream concluded that implementing the transaction at issue in this proceeding is the best way to provide for that capital investment in the future.⁷

The transaction will involve the Operating Companies transferring ownership of certain fixed assets to a newly-formed entity, Communications Sales and Leasing, Inc. (“CSL”), or one of CSL’s wholly-owned subsidiaries.⁸ CSL will not use the assets to provide telecommunications services to customers in the Commonwealth or any other state.⁹ CSL will elect to operate as a Real Estate Investment Trust (“REIT”), and will lease back these assets on an exclusive, long-term basis to Windstream Holdings, Inc. (“Holdings”), the indirect corporate

⁴ T, at 130.

⁵ *Id.*

⁶ *Id.*

⁷ *Id.*

⁸ Gunderman Direct at 3. The Transaction will also involve the creation of a new entity, Talk America Services, LLC (“TAS”), which will operate as a competitive local exchange carrier and long distance carrier in those areas of the Commonwealth where Windstream CLEC/LD companies are currently authorized. TAS will seek authority to provide such services in the Commonwealth by separate notice filings in accordance with the procedures established by the Commission in its Orders in Administrative Case No. 359 and Administrative Case No. 370. As a result of the Transaction, approximately 200 residential local and long distance customers of Windstream’s CLEC/LD companies will be transferred to TAS. The only change these customers will see is the name of the carrier that provides the service.

⁹ *Id.* at 5.

parent of the Operating Companies, for the exclusive use and benefit of the Operating Companies (the “Transaction”).¹⁰ The purpose and result of the Transaction will be to reduce long term debt resulting in increased free cash flow that the Operating Companies will use to enhance their broadband capabilities, accelerate their transition to an IP network, and pursue additional opportunities to strengthen their infrastructure and provide enhanced services to customers.¹¹

The Transaction will not result, either directly or indirectly, in a transfer of ownership, control, or the right to control the Operating Companies.¹² The Operating Companies will remain indirect, wholly-owned subsidiaries of Holdings following the Transaction.¹³ Nor will the Transaction result in any changes in rates, scope, or terms of service for customers of the Operating Companies.¹⁴ The Transaction will be seamless for customers. Following the Transaction, the Operating Companies will continue to have sole responsibility for meeting all regulatory obligations regarding their provision of telecommunications services in the Commonwealth.¹⁵ The Transaction will not remove or reduce any existing regulatory obligation of the Operating Companies.¹⁶ Therefore, the Transaction will have no impact on the Commission’s regulatory authority.

II. THE TRANSACTION

The critical elements of the Transaction at issue in this proceeding are the transfer of assets from the Operating Companies to CSL and the lease back of those assets from CSL to

¹⁰ *Id.* at 3.

¹¹ *Id.* at 3-4.

¹² *Id.* at 4.

¹³ *Id.*

¹⁴ *Id.*

¹⁵ *Id.*

¹⁶ Windstream Kentucky East, LLC and Windstream Kentucky West, LLC Responses to the Kentucky Cable Telecommunication Association’s Requests for Information (“Responses to KCTA”), No. 4.

Holdings for the long-term, exclusive use and control of the Operating Companies.

Mr. Gunderman summarized this process in his testimony at the hearing:

Well, there is a spinoff. Assets will be transferred, sold from our operating companies to CSL, and CSL will be spun off . . . as a separate public company, and then there will be . . . a lease entered into between CSL and Windstream Holdings where the operating subsidiaries of Windstream Holdings will benefit from the long-term exclusive use of those assets through this master lease. That's the structure of the transaction.¹⁷

Provided that regulatory approval is obtained, this process will occur in a number of different states where Windstream provides telecommunications services.

The first step in the Transaction is the transfer of the Subject Assets from the Operating Companies to CSL. The Subject Assets being transferred include all of the Operating Companies' passive distribution systems consisting of fiber optic cable, copper cable, conduits and conduit systems, poles, attachment hardware, guy wires, pedestals, concrete pads, central office and land buildings, signal repeaters, and amplifiers, along with all replacements, modifications, alterations, and additions, located in the Commonwealth.¹⁸ These assets are involved in the Transaction because they comprise the property owned by the Operating Companies that is capable of being held as real estate by a REIT.¹⁹ The Operating Companies will not transfer other tangible assets, including central office switches, electronics, equipment used for maintenance and repair, and backend systems such as routing, provision and billing systems.²⁰ Nor will the Operating Companies transfer any customer accounts or regulatory authorizations to CSL.²¹

¹⁷ T. at 109-110.

¹⁸ Gunderman Direct at 5.

¹⁹ T. at 120.

²⁰ Gunderman Direct at 6.

²¹ *Id.*

With respect to easements and rights-of-way, the Operating Companies will transfer the beneficial ownership rights and interests to CSL, and will retain legal title.²² Other parties will continue to interact directly with the Operating Companies with respect to the easements and rights-of-way.²³ CSL will own the right to all future income, gains or benefits from the easements and rights-of-way, as well as exposure to all risk of loss associated with those assets.²⁴ At the time of the transfer of the interest in the easements and rights-of-way, CSL will immediately and contemporaneously lease the interest back to Holding for the long-term exclusive use of the Operating Companies.²⁵ After the Transaction closes, the Operating Companies will continue utilizing the easements and rights-of-way in the same manner they do today.²⁶ There will be no operational or regulatory impact.²⁷

The second step in the Transaction is the execution of the long-term lease between CSL and Holdings that will be in effect for up to 35 years (the “Lease”). The Lease will provide the Operating Companies with the exclusive rights to use the distribution systems and to access and affix communications electronics, switching, or other equipment to the distribution systems for the provision, routing and delivery of voice, data and other communications services.²⁸ The Operating Companies’ exclusive usage rights will include the right to provide communications services or sublease access to the system.²⁹ The exercise of these rights will not be subject to approval from CSL.³⁰ Following the Transaction, the Operating Companies will have the same

²² Windstream Kentucky East, LLC and Windstream Kentucky West, LLC’s Responses to Commission Staff’s Second Request for Information (“Responses to Staff’s Second Request”), No. 1.; T. at 182-184.

²³ *Id.*

²⁴ *Id.*

²⁵ *Id.*

²⁶ *Id.*

²⁷ *Id.*

²⁸ Gunderman Direct at 6.

²⁹ *Id.*

³⁰ *Id.*, See also T. at 166-168

rights and obligations concerning the facilities used to provide telecommunications services in the Commonwealth as they do today.

Conversely, and as a direct result of the Operating Companies' exclusive right to use the leased facilities, CSL will lack the ability to provide telecommunications (or other utility) services to the public in the Commonwealth.³¹

The initial shareholders of CSL will be the shareholders of Holdings, who will receive shares of CSL in proportion to their ownership of Holdings.³² Following the distribution of the CSL shares to Holdings' shareholders, CSL and Holdings will be independent, publicly-traded companies.³³ CSL will not own, control, or possess the right to control Holdings or the Operating Companies.³⁴ CSL will not provide public utility services to any customers in the Commonwealth, nor will CSL operate any of the Subject Assets being transferred in the Transaction.³⁵ Rather, CSL will own the Subject Assets and lease them on a long term exclusive basis to Holdings for the benefit of the Operating Companies.³⁶

The Transaction will result in no change in the ownership or operation of the Operating Companies. Indeed all of the following will remain unchanged:

- The Operating Companies will remain indirect, wholly-owned subsidiaries of Holdings.³⁷
- The Operating Companies will remain responsible for all capital improvements and maintenance of all facilities used to provide telecommunications services in the Commonwealth.³⁸

³¹ Moreover, even if CSL retained a right to use the leased facilities to provide telecommunications service, and it does not, it could not maintain its status as a REIT if it were to provide those services.

³² T. at 7.

³³ *Id.*, See also T. at 108.

³⁴ *Id.*

³⁵ *Id.*

³⁶ *Id.*

³⁷ *Id.* at 8.

³⁸ *Id.*

- The Operating Companies will remain responsible for compliance with all federal, state and local legal and regulatory requirements.³⁹ The Transaction will not remove or reduce any existing regulatory obligation of the Operating Companies.⁴⁰ Therefore, the Transaction will have no impact on the Commission’s regulatory authority.
- The Operating Companies will remain the carriers of last resort in their service areas.⁴¹
- The Operating Companies will continue to provision and charge appropriate contract and or tariff rates to other carriers as necessary to fulfill their collocation and other applicable regulatory obligations to provide access to network elements.⁴²

The only change resulting from the Transaction will be that the Subject Assets will be leased for the exclusive benefit of the Operating Companies. This is not an unusual practice in the telecommunications industry. In fact, the Operating Companies’ wireless competitors already employ a similar practice with their towers.⁴³ Immediately upon the transfer and lease back of the Subject Assets, the Operating Companies will continue to provide the same services they do today, at the same rates and pursuant to the same tariffs, under the same name.⁴⁴ No customers will be transferred from the Operating Companies as a result of the Transaction.⁴⁵

III. REQUEST FOR DECLARATORY ORDER

The Commission has the authority to issue a Declaratory Order pursuant to 807 KAR 5:001, Section 19.⁴⁶ A Declaratory Order should be entered finding that Commission approval pursuant to KRS 278.020 is not required for the Transaction.

³⁹ *Id.*

⁴⁰ Responses to KCTA, No. 4.

⁴¹ *Id.*

⁴² *Id.*

⁴³ *Id.* at 7.

⁴⁴ *Id.* at 8.

⁴⁵ *Id.* at 9.

⁴⁶ The regulation provides, in pertinent part, as follows: “The commission may, upon application by a person substantially affected, issue a declaratory order with respect to the jurisdiction of the commission, the applicability to a person, property, or state of facts of an order or administrative regulation of the commission or provision of KRS Chapter 278, or with respect to the meaning and scope of an order or administrative regulation of the commission or provision of KRS Chapter 278.”

KRS 278.020(5) provides that “[n]o person shall acquire or transfer ownership of, or control, or the right to control, any utility under the jurisdiction of the commission by sale of assets, transfer of stock, or otherwise, or abandon the same, without prior approval by the commission.” Similarly, KRS 278.020(6) provides in pertinent part as follows:

No individual, group, syndicate, general or limited partnership, association, corporation, joint stock company, trust, or other entity (an “acquirer”), whether or not organized under the laws of this state, shall acquire control, either directly or indirectly, of any utility furnishing utility service in this state, without having first obtained the approval of the commission. Any acquisition of control without prior authorization shall be void and of no effect. As used in this subsection, the term “control” means the possession, directly or indirectly, of the power to direct or cause the direction of the management and policies of a utility, whether through the ownership of voting securities, by effecting a change in the composition of the board of directors, by contract or otherwise.

These statutes impose an obligation to obtain Commission approval to transfer or acquire an interest of ownership or control in an existing utility. They are inapplicable in this instance because the Transaction will not result in the acquisition or transfer of ownership, control or the right to control the Operating Companies.

The Transaction will not result in CSL acquiring any ownership interest in the Operating Companies, either directly or indirectly through Holdings.⁴⁷ To the contrary, CSL and Holdings will be independent, public traded companies engaged in different businesses.⁴⁸ No securities are being transferred from the Operating Companies or Holdings to CSL, and CSL’s ownership interest will be limited to the Subject Assets being transferred by the Operating Companies.⁴⁹ Accordingly, its ownership interest will be limited to certain property used by a utility and will not extend to ownership of the utility itself.

⁴⁷ Direct Testimony of John P. Fletcher (“Fletcher Direct”) at 4.

⁴⁸ *Id.*

⁴⁹ *Id.*

Nor will the Transaction allow CSL to exercise any control over the Operating Companies or the Subject Assets.⁵⁰ CSL will not possess the power to direct or cause the direction of the management and policies of the Operating Companies.⁵¹ CSL will not own voting securities in Holdings or the Operating Companies and will have no ability to effect a change in the Boards of Directors of Holdings or the Operating Companies.⁵² Moreover, no contract will authorize CSL to exercise control over the Operating Companies.⁵³ To the contrary, the Lease will ensure that the Operating Companies retain long term exclusive control over the Subject Assets.⁵⁴ This point was addressed by Holdings' General Counsel, John P. Fletcher, in his direct testimony:

The Master Lease will ensure that the Operating Companies have long term, exclusive control over the Subject Assets. In addition, following the Transaction, the Operating Companies will continue to be responsible for all capital improvements to the Subject Assets, along with their maintenance and operation. The Operating Companies will remain carriers of last resort in their service areas, and will retain their existing and future contractual and regulatory obligations as telecommunications utilities in the Commonwealth. Under the terms of the exclusive lease from CSL, the Operating Companies will be responsible for the operation and maintenance of the Subject Assets and will continue to have responsibility for quality of service standards and fulfillment of all regulatory obligations.⁵⁵

Nothing in the record suggests that CSL will own or control the Operating Companies as a result of the Transaction. Accordingly, approval is not required under KRS 278.020(5) or (6).

⁵⁰ *Id.*

⁵¹ *Id.* at 6.

⁵² *Id.*

⁵³ *Id.*

⁵⁴ *Id.* at 5.

⁵⁵ *Id.* at 5; *See also* T. at 166-168.

IV. REQUEST FOR APPROVAL UNDER KRS 278.020(5) and KRS 278.020(6)

If the Commission nevertheless determines that approval for the Transaction is necessary under KRS 278.020(5) or KRS 278.020(6), the Operating Companies have demonstrated that the applicable requirements have been satisfied and that the Transaction should be approved.

A. Approval is Appropriate Under KRS 278.020(5)

KRS 278.020(5) provides that the Commission shall grant approval for the acquisition or transfer of the ownership, control or right to control a utility “if the person acquiring the utility has the financial, technical, and managerial abilities to provide reasonable service.” To the extent Commission approval is required under this statute, the Transaction satisfies each of these requirements. Although the Subject Assets will be transferred to CSL, the Operating Companies, and not CSL, will continue to operate the Subject Assets to provide telecommunications services to the public in the Commonwealth. Following the Transaction, the Operating Companies will continue to be managed and operated by the same capable, experienced executives and employees. The Operating Companies will therefore maintain the same technical and managerial ability to provide reliable, high-quality services as they do today. The Operating Companies currently possess the financial ability to provide the certificated services to the public, and this ability will be enhanced by the Transaction. Accordingly, it is clear that the Operating Companies will continue to possess the technical, managerial, and financial ability to provide reasonable service.

1. Financial Capabilities

The Transaction, will enhance the financial capabilities of the Operating Companies and Holdings.⁵⁶ The Transaction will accomplish this in three ways. First, the Transaction will result in the immediate reduction of approximately \$3.2 billion in the long-term debt of

⁵⁶ Gunderman Direct at 10.

Holdings.⁵⁷ Second, the lease payment from Holdings to CSL will be deductible for federal income tax purposes, which will produce a tax benefit of approximately \$247 million. Third, the annual dividend paid to Holdings' shareholders will be reduced from \$1 to \$.10, which will result in additional savings of approximately \$540 million.⁵⁸ The resulting free cash flow from these steps is expected to permit the Operating Companies to increase their target capital expenditures from 11-13% to 13-15% of total revenue.⁵⁹ Accordingly, the Transaction will have a positive impact on the Operating Companies' financial strength and capabilities.

2. Technical Capabilities

The Subject Assets will be leased back to Holdings for the long-term exclusive benefit of the Operating Companies, whose personnel will continue to operate the Subject Assets.⁶⁰ Thus, the Transaction will have no impact on the employees of the Operating Companies and all functions and services will continue to be provided in the same manner as they are today.⁶¹ This point was made clear in testimony offered by Mr. Fletcher at the hearing in response to counsel for the Communications Workers of America:

Q. Are any Kentucky ILEC employees being transferred to CSL?

A. No.

Q. Are any ILEC employees—or, excuse me, are any Windstream employees who are covered by a collective bargaining agreement being transferred to CSL?

A. No.

Q. Is any work performed by employees of the Kentucky ILEC being eliminated as a result of this transaction?

⁵⁷ *Id.*

⁵⁸ T. at 55.

⁵⁹ *Id.* at 31-32; Gunderman Direct at 10.

⁶⁰ *Id.*

⁶¹ Gunderman Direct at 10-11.

A. No.

Q. And is any of that work being transferred to CSL?

A. No.

Q. Will CSL employees or contractors perform any work on the Kentucky ILEC facilities?

A. That is not expected. All work to be performed by the Windstream entities, who will have the exclusive right to perform that work.

Q. Okay. So all of that work will continue to be performed by employees of the Kentucky ILEC as they do today?

A. As they do today, correct.

Q. Do you anticipate any change in the number or type of employees in Kentucky as a result of this transaction?

A. No.⁶²

Indeed, the Transaction is anticipated to be beneficial for employees of the Operating Companies because it will enable them to work for stronger companies that have better opportunities for growth moving forward.⁶³

The Operating Companies additional free cash flow will permit them to expand their broadband network and deliver enhanced services.⁶⁴ Indeed, the fundamental purpose of the Transaction is to facilitate capital investment in the Operating Companies to remain competitive in the marketplace for telecommunications services. Such investment will build on the Operating Companies already strong existing technical capabilities.

⁶² T. at 148-149.

⁶³ T. at 106.

⁶⁴ Gunderman Direct at 10.

3. Managerial Capabilities

The Operating Companies will continue to employ personnel experienced and dedicated to the provision of high-quality communications service.⁶⁵ The customer service, network and operations functions critical to the success of the Operating Companies today will continue, and the business will be staffed to ensure that continuity.⁶⁶ For example, the local operations will continue to be staffed and managed by employees who have established ties to the community and extensive knowledge of the local telecommunications business.⁶⁷

The Operating Companies will continue to receive the same centralized management services they do today.⁶⁸ They will be staffed by experienced and knowledgeable people currently providing these services.⁶⁹ Presently, centralized functions include human resources, finance, tax, media, legal, planning, general support, and information services.⁷⁰ The Operating Companies benefit from the efficiencies enjoyed with these centralized support services. These benefits will continue following the Transaction.⁷¹

B. Approval is Appropriate Under KRS 278.020(6)

KRS 278.020(6) provides in pertinent part that the Commission shall approve a proposed transaction subject to its provisions upon a finding that the proposed transaction “is to be made in accordance with law, for a proper purpose and is consistent with the public interest.” The Transaction satisfies each of these requirements.

⁶⁵ *Id.* at 10.

⁶⁶ *Id.* at 11.

⁶⁷ *Id.*

⁶⁸ *Id.*

⁶⁹ *Id.*

⁷⁰ *Id.*

⁷¹ *Id.*

1. Proper Purpose

The Transaction is being carried out for a proper purpose. The Operating Companies operate in an industry that has been and continues to be subject to rapid technological advances, evolving consumer preferences, and dynamic change.⁷² To remain competitive, the Operating Companies need to increase their financial flexibility by means of efforts like the Transaction to facilitate further investments in their network that will enable them to continue to provide and enhance the full range of services they provide to customers in the Commonwealth.⁷³ The Transaction will enable the Operating Companies to become a more nimble competitor by increasing their financial flexibility in the highly competitive telecommunications service market that is characterized by stagnant or falling demand and largely fixed costs.⁷⁴ It will do so without any reduction in competition and without removing any customer choices from the marketplace.⁷⁵

If the Operating Companies do nothing, they will be under growing pressure to increase revenues per line, as line counts are generally declining even as many fixed costs remain stable or increase.⁷⁶ The financial efficiencies that will result from the Transaction will help relieve that pressure.⁷⁷ The efficiencies will enable the Operating Companies to continue offering basic services at affordable prices and will provide greater resources to invest in new services.⁷⁸ Additionally, the Transaction will better enable the Operating Companies to compete in the marketplace. The additional capital investments will allow the Operating Companies to satisfy the data and content requirements of consumers and businesses, which are increasing and

⁷² *Id.* at 13.

⁷³ *Id.*

⁷⁴ *Id.*

⁷⁵ *Id.*

⁷⁶ *Id.*

⁷⁷ *Id.*

⁷⁸ *Id.* at 14.

changing rapidly and significantly, while also providing the latest technology at levels that meet or exceed those of their competitors.⁷⁹ Accordingly, the Commission should find that the Transaction is being carried out for a proper purpose.

2. Accordance with the Law.

The Transaction is being undertaken in accordance with the law. In Kentucky, the Operating Companies are seeking a declaratory order from the Commission that approval for the Transaction is not required. If the Commission finds that approval is necessary, the Operating Companies are seeking approval for the Transaction under KRS 278.020(5) and KRS 278.020(6). Similar efforts are being undertaken in other jurisdictions. In other states involving ILEC operations, approval for the Transaction has already been obtained in Alabama and North Carolina and is expected to be obtained by the end of 2014 in Georgia and Ohio.⁸⁰ Importantly, no jurisdictions have denied approval for the Transaction.⁸¹

There are sufficient facts in the record of this proceeding for the Commission to also grant its approval for the Transaction. While it is true that certain documents have not been finalized, there is no dispute in the record that the information provided by the Operating Companies includes all of the material terms of the Transaction. Mr. Fletcher addressed this point succinctly at the hearing:

First of all, we think that the summaries that have been provided cover the material terms and we do not expect those to be changed in any material way, and certainly in any adverse way to the operating companies, but what—one question was asked this morning, “What happens if a state comes out?” Well, we’re not going to just keep the rent at 650 million if a state is pulled from the transaction due to failure of regulatory approval. That’s the biggest remaining open thing, I think, that is—that is to be determined, and that’s what we’re here today to do is to confirm

⁷⁹ *Id.*

⁸⁰ T. at 175.

⁸¹ *Id.*

the terms in which we can include the Kentucky properties. So that's really the big point.

And then the provisions you're not seeing I would couch as the traditional guardrails and parameters any landlord would put on a commercial tenant . . . It's a very lengthy, cumbersome commercial agreement, and we have summarized the key provisions, and I think that these summaries you have today do capture the material terms that the PSC needs to understand to be able to approve the transactions.⁸²

The material terms of the Transaction are before the Commission. They cannot be finalized until regulatory approval is obtained from the Commission and the other jurisdictions where approval has been sought. However, it is clear that no material terms will be changed in a manner that is detrimental to the Operating Companies.⁸³ The material terms have all been disclosed in this proceeding in the Application and responses to data requests. To the extent the Commission and other parties have sought relevant information from the Operating Companies, that information has been provided. The Operating Companies have agreed to file a copy of the Lease with the Commission when it is finalized and executed, and the Commission has the authority to follow the lead of Alabama and North Carolina in conditioning its approval of the Transaction on the accuracy of the Application.⁸⁴

3. Public Interest

The public interest supports the Commission's approval of the Transaction. The Operating Companies' customers will experience no change, other than the expected improvements in service as the financial benefits of the Transaction are recognized in further capital investments.⁸⁵ Customers will receive at least the same high-quality local exchange and long distance service as they do today, subject to the same rules, regulations, and applicable

⁸² T. at 164-165.

⁸³ *Id.* at 165.

⁸⁴ T. at 175-176.

⁸⁵ Gunderman Direct at 15.

tariffs.⁸⁶ Further, subsequent end user rate changes, if any, will continue to be governed by the same rules and procedures.⁸⁷ Similarly, the terms and prices for existing wholesale services under applicable access tariffs or agreements will remain unchanged as a result of the Transaction.⁸⁸ Nor will the Transaction impact the terms of any existing interconnection agreements or other obligations under state and federal laws regarding interconnection.⁸⁹ The Transaction will have no adverse impact on any customers or other providers that use the Operating Companies' facilities. Furthermore, the Transaction will not remove or reduce any existing regulatory obligation of the Operating Companies and will have no impact on the Commission's regulatory authority.

As with other real estate involved in the Transaction, poles will be transferred from the Operating Companies to CSL and leased back to Holdings for the long-term, exclusive use of the Operating Companies. This transfer will have no impact on third party pole attachment agreements or rates.⁹⁰ Specifically, the Transaction will have no effect on pole attachment rates. The rates will remain tariffed following the closing of the Transaction and will remain subject to the Commission's review and approval.⁹¹ Moreover, the Transaction will have no impact on the value of the poles for ratemaking purposes going forward because the poles will remain on the Applicants' balance sheets at their current values.⁹²

V. CSL DOES NOT REQUIRE A CERTIFICATE UNDER KRS 278.020(1)

KRS 278.020(1) provides in pertinent part that “[n]o person, partnership or private corporation, or combination thereof shall commence providing utility service **to or for the**

⁸⁶ *Id.*

⁸⁷ *Id.*

⁸⁸ *Id.*

⁸⁹ *Id.*

⁹⁰ Responses to Staff's Second Request, No. 2.

⁹¹ *Id.*

⁹² Windstream Kentucky East, LLC and Windstream Kentucky West, LLC's Responses to the Commission Staff's Post-Hearing Data Requests, No. 6.

public or begin the construction of any plant, equipment, property, or facility for furnishing **to the public** any of the services enumerated in KRS 278.010 . . . until that person has obtained from the Public Service Commission a certificate that public convenience and necessity require the service or construction.”⁹³ The requirement of service “to of for the public” is repeated in the definition of a telecommunications “utility” found in KRS 278.010(3)(e), which provides in pertinent part that the term “utility” includes “any person . . . who owns, controls, operates, or manages any facility used or to be used for or in connection with: The transmission or conveyance over wire, in air, or otherwise, of any message by telephone or telegraph **to or for the public**, for compensation.”⁹⁴ CSL will not be a utility because it will not be providing any telecommunications services to or for the public. Accordingly, no authorization is required.

CSL will not be engaged in the “transmission or conveyance over wire, in air, or otherwise, of any message by telephone or telegraph to or for the public.” CSL instead will possess an ownership interest in certain communications infrastructure that it will lease pursuant to an exclusive long-term agreement to a single customer—Holdings.⁹⁵ The Operating Companies, and not CSL, will continue to operate and maintain the Subject Assets for the purpose of providing telecommunications services.⁹⁶ In addition, because the switches and other electronics will not be transferred to CSL, the entirety of the assets to be owned by CSL are incapable of providing telecommunications service.⁹⁷ Accordingly, CSL is not required to obtain a certificate of public convenience and necessity under KRS 278.020(1).

This conclusion is buttressed by the definition of utility set out in KRS 278.010(3)(e). It defines a utility to include “any person . . . who owns, controls, operates, or manages any facility

⁹³ Emphasis added.

⁹⁴ Emphasis added.

⁹⁵ Fletcher Direct at 7.

⁹⁶ *Id.*

⁹⁷ *Id.*

used or to be used for or in connection with . . . [t]he transmission or conveyance over wire, in air, or otherwise, of any message by telephone or telegraph **for the public**, for compensation.”⁹⁸

CSL will not hold itself out as willing to provide telecommunications services to anyone, and will be precluded from using the Subject Assets to do so under the terms of the Lease.⁹⁹ It will not have retail or wholesale telecommunications services customers, and will not receive any compensation from the public as a result of its ownership of the Subject Assets.¹⁰⁰

Indeed, the provision of utility services is antithetical to CSL’s existence as a REIT. CSL will be unable to maintain its status as a REIT if it provides telecommunications services to the public. Under the Internal Revenue Code, a REIT must receive at least 95 percent of its revenue from dividends and rents, and the revenues generated from the provision of telecommunications services to the public will not qualify.¹⁰¹ Accordingly, with limited exceptions, a REIT can only own real estate and receive income in the form of rent, and cannot engage in any other activities.¹⁰² CSL intends to maintain its status as an REIT.¹⁰³ Its only activities in the Commonwealth will be to own the Subject Assets and lease them back to Holdings for the exclusive, long-term use by the Operating Companies.¹⁰⁴ CSL will not be a utility under KRS 278.010(3)(e) and it will not be providing any utility services to or for the public sufficient to trigger the requirements of KRS 278.020(1).

CSL’s status as a non-utility is consistent with Commission precedent addressing the “for the public” requirement. As construed by the Commission the term requires that the entity being holding itself out to provide services to and for the public:

⁹⁸ Emphasis added.

⁹⁹ *Id.* at 8.

¹⁰⁰ *Id.*

¹⁰¹ *Id.*

¹⁰² *Id.*

¹⁰³ *Id.*

¹⁰⁴ *Id.*

As the name indicates, the term “public utility” implies a public use and service to the public; and indeed, the principal determinative characteristic of a public utility is that of service to, or readiness to serve, an indefinite public (or a portion of the public as such) which has a legal right to demand and receive its services and commodities. There must be a dedication or holding out, either express or implied, of produce [sic] or services to the public as a class. The term precludes the idea of service which is private in nature and is not to be obtained by the public.”¹⁰⁵

CSL will not be providing utility services to anyone, and certainly not to an indeterminate public.

Rather, it will simply be leasing property to Holdings so that the Operating Companies can continue to provide utility services subject to the Commission’s jurisdiction.

Indeed, the Commission has recognized that a party does not provide “utility services” under KRS 278.020(1) when it owns facilities that are used exclusively to provide wholesale service.¹⁰⁶ The Commission has found that such service is not “regulated activity” subject to the Commission’s jurisdiction. In reaching that conclusion, the Commission has reasoned as follows:

The Commission further finds that the definitions set forth in KRS Chapter 278 include the term “regulated activity,” which “means a service provided by a utility or other person, the rates and charges of which are regulated by the commission. Under this definition, the wholesale transmission service that KY Transco proposes to offer would not be a regulated activity, since the rates and charges for KY Transco’s transmission service would not be regulated by the Commission. And since the only service that KY Transco is requesting authority to offer is wholesale transmission service, by law, KY Transco would not be providing a regulated service within the parameters of the Commission’s jurisdiction under KRS Chapter 278.”¹⁰⁷

¹⁰⁵ See, e.g., *In the Matter of: Petition of Kentucky Mountain Power, L.L.C. for a Declaratory Order*, Case No. 2001-00007 (March 19, 2001) (Finding that an Electric Wholesale Generator is not a utility).

¹⁰⁶ See *In the Matter of: Application of AEP Kentucky Transmission Company, Inc. for a Certificate of Public Convenience and Necessity Pursuant to KRS 278.020 to Provide Wholesale Transmission Service in the Commonwealth*, Case No. 2011-00042 (June 10, 2013).

¹⁰⁷ *Id.* (Internal citation omitted).

This rationale applies with equal force here. CSL will own certain facilities used to provide telecommunications service. However, its function will be limited to leasing those facilities back to the Operating Companies. It will not be engaged in any “regulated activity” under KRS Chapter 278. That activity will continue to be performed by the Operating Companies, which will remain subject to the Commission’s jurisdiction to the extent they are today.

Additionally, the Commission has declined to assert jurisdiction over parties that hold some ownership interest in utility facilities but do not provide any utility services directly. The situation has arisen in the context of financing agreements where utilities sell or lease facilities to financial institutions for a period of years, and then leaseback the facilities to provide service to their customers. The Commission has approved these arrangements without requiring the financial institutions to obtain Certificates of Public Convenience and Necessity as a result of their ownership interests in the utility facilities.¹⁰⁸ In those cases, the financial institutions held ownership interests in the facilities as a result of the long-term lease arrangements. However, the facilities continued to be used by the existing utilities to provide services.

The Transaction at issue in this proceeding involves a fundamentally similar arrangement. CSL will hold an ownership interest in certain facilities and those facilities will continue to be used by the Operating Companies, along with the property they have retained, to provide telecommunications services. Accordingly, it is consistent with established precedent for the Commission to find that CSL is not a utility and that it is not required under KRS 278.020(1) to obtain a Certificate of Public Convenience and Necessity.

¹⁰⁸ See, e.g., *In the Matter of: Application of Bullock Pen Water District for Approval to Enter Into a Lease Agreement with the Bank of Kentucky, Inc. in a Principal Amount of \$860,000.00 for the Purpose of Refinancing Certain Outstanding Debt Obligations Between the Kentucky Rural Water Finance Corporation and the Bullock Pen Water District*, Case No. 2012-00507 (January 4, 2013) (Involved a ten year lease and leaseback); *In the Matter of: Carroll County Water District No. 1’s Application for a Certificate of Public Convenience and Necessity for the Construction of Facilities for the District and Approval of a Lease Agreement in the Principal Amount of \$1,250,000 to Finance Such Facilities and to Refund Certain Prior Indebtedness*, Case No. 95-00062 (February 22, 1995) (Involved a twenty year lease and leaseback).

VI. CONCLUSION

The Operating Companies respectfully request that the Commission enter an Order declaring that no approval is required for the Transaction under KRS 278.020(1), (5) or (6). In the alternative, the Operating Companies request an Order approving the Transaction under KRS 278.020(5) and (6).

Respectfully submitted,



Mark R. Overstreet
R. Benjamin Crittenden
STITES & HARBISON PLLC
421 West Main Street
P.O. Box 634
Frankfort, KY 40602-0634
Telephone: (502) 223-3477
Email: moverstreet@stites.com
bcrittenden@stites.com

COUNSEL FOR WINDSTREAM KENTUCKY
EAST AND WINDSTREAM KENTUCKY WEST

CERTIFICATE OF SERVICE

I hereby certify that a copy of the foregoing was served by United States First Class Mail, postage prepaid, on this 26th day of November, 2014 upon:

Don Meade
Priddy, Cutler, Naake & Meade, PLLC
800 Republic Bldg.
429 W. Muhammad Ali Blvd.
Louisville, KY 40202

Scott Rubin
333 Oak Lane
Bloomsburg, PA 17815

Douglas F. Brent
Stoll Keenon Ogden
2000 PNC Plaza
500 W. Jefferson Street
Louisville, KY 40202-2828

Gardner F. Gillespie
Sheppard Mullin Richter & Hampton LLP
2099 Pennsylvania Ave. N.W., Ste. 100
Washington, D.C. 2006-6801



Counsel for Windstream