BEFORE THE STATE CORPORATION COMMISSION
OF THE STATE OF KANSAS

In the Matter of the Joint Application of Consolidated Communications Holdings, Inc. and FairPoint Communications, Inc., For Approval of the Proposed Acquisition of the Common Stock of FairPoint Communications, Inc. By Consolidated Communications Holdings, Inc. and the Resulting Transfer of Control of Bluestem Telephone Company, Inc., Sunflower Telephone Company, Inc., FairPoint Communications of Missouri, Inc. and ST Long Distance, Inc. to Consolidated Communications Holdings, Inc.	)	Docket No. 17-SFLT-283-ACQ

NOTICE OF FILING OF STAFF'S REPORT AND RECOMMENDATION

The Staff of the Kansas Corporation Commission ("Staff" and "Commission," respectively) hereby files its Report and Recommendation ("R&R") dated April 27, 2017, regarding the Joint Application filed by Consolidated Communications Holdings, Inc. ("CCHI") and FairPoint Communications, Inc. ("FRP") on January 7, 2017. Staff recommends the Commission take the following actions:

1) Approve the Joint Application for CCHI to acquire the common stock of FRP ("Transaction"); and

2) Formalize CCHI's statements that no portion of the acquisition premium incurred as a result of the Transaction will be recovered from Kansas ratepayers, whether through rates or the Kansas Universal Service Fund (KUSF).

WHEREFORE, Staff respectfully submits its R&R for Commission consideration.

Respectfully Submitted,

Michael Neeley, S. Ct. #25027
Litigation Counsel
Kansas Corporation Commission
1500 S.W. Arrowhead Road
Topeka, Kansas 66604-4027
Phone: 785-271-3173
Fax: 785-271-3167

STATE OF KANSAS)
) ss.
COUNTY OF SHAWNEE)

VERIFICATION

Michael Neeley, being duly sworn upon his oath deposes and states that he is Litigation Counsel for the State Corporation Commission of the State of Kansas, that he has read and is familiar with the foregoing *Notice of Filing of Staff's Report and Recommendation* and that the statements contained therein are true and correct to the best of his knowledge, information and belief.

Michael Neeley # 25027
Kansas Corporation Commission of the
State of Kansas

Subscribed and sworn to before me this 1st day of May, 2017.

PAMELA J. GRIFFETH
Notary Public - State of Kansas
My Appt. Expires 08-17-2019

Notary Public

My Appointment Expires: August 17, 2019

Utilities Division
1500 SW Arrowhead Road
Topeka, KS 66604-4027

Kansas
Corporation Commission

Phone: 785-271-3220
Fax: 785-271-3357
http://kcc.ks.gov/

REPORT AND RECOMMENDATION
UTILITIES DIVISION

TO: Chairman Pat Apple
Commissioner Shari Feist Albrecht
Commissioner Jay Scott Emler

FROM: Adam Gatewood, Managing Financial Analyst
Sandy Reams, Assistant Chief of Telecommunications
Christine Aarnes, Chief of Telecommunications
Justin Grady, Chief Auditor
Jeff McClanahan, Utilities Division Director

DATE: April 27, 2017

SUBJECT: Docket No: 17-SFLT-283-ACQ
In the Matter of the Joint Application of Consolidated Communications Holdings, Inc. and FairPoint Communications, Inc., For Approval of the Proposed Acquisition of the Common Stock of FairPoint Communications, Inc. By Consolidated Communications Holdings, Inc. and the Resulting Transfer of Control of Bluestem Telephone Company, Inc., Sunflower Telephone Company, Inc., FairPoint Communications of Missouri, Inc. and ST Long Distance, Inc. to Consolidated Communications Holdings, Inc.

EXECUTIVE SUMMARY:

On January 7, 2017, Consolidated Communications Holdings, Inc. (CCHI) and FairPoint Communications, Inc. (FRP) filed a Joint Application seeking approval for CCHI to acquire the common stock of FRP ("Transaction"). The proposed Transaction will result in the transfer of control of Bluestem Telephone Company, Inc. (Bluestem); Sunflower Telephone Company, Inc. (Sunflower); FairPoint Communications Company of Missouri, Inc. (FairPoint MO); and ST Long Distance, Inc. (STLD) from FRP to CCHI (Joint Applicants). The Joint Applicants expect the Transaction to close by the end of June 2017 and request the Commission expedite the Application.[1] The Joint Applicants addressed the Commission's Merger Standards[2] and state the proposed Transaction is in the public interest.

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[1] Joint Application of Consolidated Communications Holdings, Inc. and FairPoint Communications, Inc. For Approval of the Proposed Acquisition of the Common Stock of FairPoint Communications, Inc. by Consolidated Communications Holdings, Inc. and the Resulting Transfer of Control of Bluestem Telephone Company, Inc., Sunflower Telephone, Company, Inc., FairPoint Communications Company of Missouri, Inc. and ST Long Distance, Inc. (Joint Application), ¶ 13.

Staff reviewed and analyzed the proposed Transaction based on Kansas statutes and the Merger Standards to determine whether the Transaction promotes the public interest. Staff concludes that the proposed Transaction would promote the public interest and recommends approval of the Transaction. Staff recommends that the Commission's Order approving the Transaction formalize the Joint Applicants' statements that the acquisition premium will not be recovered from Kansas ratepayers, whether through rates or the Kansas Universal Service Fund (KUSF).

I. BACKGROUND:

A. Parties to the Transaction:

CCHI, headquartered in Mattoon, Illinois, provides telecommunications and internet services in 11 states, with broadband services producing a majority of its revenues.[3] CCHI owns Consolidated Communications Enterprises Services, Inc. (CCES); a certificated competitive local exchange and interexchange carrier (CLEC and IXC, respectively), as well as a video service provider in Kansas.

FRP, headquartered in Charlotte, North Carolina, provides telecommunications services in 17 states. FRP owns three Kansas rural incumbent local exchange carriers[4] (RLEC and ILEC, respectively) - Sunflower, Bluestem, and FairPoint MO.[5] The Kansas RLECs operate under price cap regulation in the federal jurisdiction[6] and under rate-of-return regulation in Kansas. FRP also owns STLD, a certificated IXC in Kansas. The Commission has jurisdiction to supervise and control ILECs pursuant to K.S.A. 66-1,188.

The RLECs provide local exchange, intra- and interLATA toll, internet, and ancillary services to approximately 3,000 residential and single-line business customers. Bluestem serves 500 lines, Sunflower serves 2,300 lines and FairPoint-MO serves 220 lines. STLD provides IXC service to approximately 2,300 customers.[7]

In January of 2007, FRP purchased exchanges in Maine, New Hampshire, and Vermont from Verizon. This single transaction increased FRP's size more than five-fold, resulting in FRP being the eighth largest telephone company in the U.S. at the time.[8] FRP took on a considerable amount of debt to complete this transaction and, coupled with operational problems, caused its post-acquisition cash-flows to be lower than anticipated, jeopardizing FRP's ability to meet its minimum credit ratios required by lenders and its ability to make timely interest payments.

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[2] Docket No. 16-ITCE-512-ACQ, Aug. 9, 2016 Order on Merger Standards, available for viewing at: http://estar.kcc.ks.gov/estar/ViewFile.aspx/20160809133328.pdf?Id=6ff4c577-59ee-47f9-9fc9-bc735d064a9c. The Merger Standards were recently affirmed in Docket 16-KCPE-593-ACQ.

[3] CCHI's SEC Form 10-K for 2016, filed March 1, 2017, p. 2.

[4] K.S.A. 61-1,187.

[5] FRP purchased Cass County Telephone in Docket No. 06-FCMT-858-COC (Docket 06-858). Per K.S.A. 66-2009, Fairpoint-MO, Cass County's successor, serves as Carrier of Last Resort and was designated as an Eligible Telecommunications Carrier. See also response to Staff DR 3.

[6] *In the Matter of Petition of FairPoint Communications, Inc., for Waiver of Section 61.41(b) and (c) of the Commission's Rules*, WC Docket No. 07-66, Order, rel. Jan. 25, 2008.

[7] STLD's 2015 Annual Interrogatory.

[8] In 2008, FRP served 305,777 access lines. The 2009 acquisition of the Verizon exchanges in Maine, Vermont and New Hampshire added 1,435,000 access lines for a total of 1,721,709 access lines.

In September of 2009, Staff requested that the Commission open a docket to investigate and monitor FRP's financial health and restructuring, citing the potential negative impacts FRP's financial problems could have on the Kansas RLECs. The Commission opened Docket 10-GIMT-049-GIT (Docket 10-049) as a vehicle for Staff to monitor FRP's restructuring. In October 2009, FRP filed for Chapter 11 bankruptcy protection and completed the bankruptcy and reorganization in January of 2011. The Commission closed Docket 10-049 in October of 2011.

B. Proposed Transaction:

CCHI seeks to acquire all of the equity interest of FRP, which will exist as a wholly-owned indirect subsidiary of CCHI, with control of the RLECs and STLD transferred to CCHI. The Transaction is a stock-for-stock transaction; meaning FRP shareholders will not receive cash but will become stockholders in the combined company. A stock-for-stock transaction does not involve the issuance of additional debt to finance the payment to FRP shareholders; they will only receive stock in CCHI.

Under the terms of the proposed Transaction, FRP shareholders will receive a fixed exchange ratio of 0.73 shares of CCHI common stock for each share of FRP common stock; a premium of 17.3% to the 30-day average of FRP's stock price as of December 2, 2016. The implied offer-price from this exchange ratio is $17.00 per share, which varies with CCHI's actual stock price. After the Transaction closes, CCHI's stockholders will own approximately 71% of the combined company and FRP's stockholders will own the remaining 29%.[9] Additionally, CCHI's Board of Directors expects to maintain its current $1.55 per share annual dividend; contrasting with FRP not paying a dividend since its restructuring in 2011. CCHI will issue the same level of debt as currently exists on FRP's books but will refinance FRP's existing debt on more favorable terms. Although no debt will be issued at the RLEC or STLD level, CCHI will pledge the RLECs' assets to support the credit facilities and new debt used in the Transaction.[10] The Joint Applicants state the proposed Transaction will not affect the Commission's jurisdiction over the RLECs, STLD, or CCES[11], and the companies will retain their current COCs and tariffs. The Transaction results in a change in control of the RLECs and STLD and, therefore, requires Commission review and action under K.S.A. 66-131, K.S.A. 66-136[12] and 66-2005(w).

C. Standards of Review:

This Transaction affects the ultimate ownership and control of the RLECs, thus, pursuant to K.S.A. 66-136, the Commission has jurisdiction to review this Transaction to ensure the Transaction promotes the public convenience. Additionally, K.S.A. 66-2005(w) requires, in part:

> [T]elecommunications carriers that were not authorized to provide switched local exchange telecommunications services in this state as of July 1, 1996 ... must

[9] FRP's SEC Form 425 filed Dec. 5, 2016, by CCHI.
[10] Direct Testimony of Michael J. Shultz filed Jan. 9, 2017 (Shultz Direct), 17-SFLT-283-ACQ, p. 19, ln 6.
[11] Id., p. 22, ln 1-13.
[12] See, e.g., Docket No. 14-KGSG-100-MIS (Docket 14-100), Dec. 19, 2013 Order Approving Unanimous Settlement Agreement, ¶ 29-30; Docket No. 07-BHCG-1063-ACQ (Docket 07-1063); and Docket No. 07-KCPE-1064-ACQ (Docket 07-1064), May 15, 2008 Order Granting Joint Motions to Adopt Stipulation and Agreement and Approving Agreements, ¶ 6.

> receive a certificate of convenience based upon a demonstration of technical, managerial and financial viability and the ability to meet quality of service standards established by the commission.

K.S.A. 66-131 and 66-136 provide that a public utility cannot transact business until it has obtained a Certificate of Convenience (COC) from the Commission that the public convenience will be promoted and the Commission approves the assignment or transfer of a COC. Specifically, K.S.A. 66-136 states,

> No franchise or certificate of convenience and necessity granted to a common carrier or public utility governed by the provisions of this act shall be assigned, transferred or leased, nor shall any contract or agreement with reference to or affecting such franchise or certificate of convenience and necessity or right thereunder be valid or of any force or effect whatsoever, unless the assignment, transfer, lease, contract or agreement shall have been approved by the commission...

In determining whether a COC should be assigned or transferred, the public convenience ought to be the Commission's primary concern, the interest of the public utility company already serving the territory secondary, and the desires of the Applicants, a relatively minor consideration.[13] The public convenience means the convenience of the public, not of any particular individual. Public necessity means a public need without which the public would be inconvenienced.[14] The public convenience and necessity is established by proof of the conditions existing in the territory to be served.[15]

The Commission has determined mergers and acquisitions involving Kansas utilities must provide positive benefits to the State of Kansas to be in the public interest.[16] The Commission established Merger Standards to analyze the level of benefits arising from such a transaction and to assess whether a transaction meets the public interest test. The Merger Standards were derived through an analysis of a transaction that involved two electric utilities with aggregate customer count of well over a half-million retail customers in Kansas; however, the Commission has recognized that each jurisdictional utility acquisition and/or merger is unique in the manner and the degree to which it affects Kansas communities, Kansas consumers, and the utilities' shareholders.

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[13] Kansas Gas & Electric Co. v. Public Service Commission, 122 Kan. 462, 466, 251 P.1097 (1977).

[14] Atchison, Topeka & Santa Fe Railway Co v. Public Service Commission, 130 Kan. 777, 288 P. 755 (1930); Central Kansas Power Co. v. State Corporation Commission, 206 Kan 670, 482 P.2d 1 (1970).

[15] Atchison, Topeka & Santa Fe Railway Co. v. Public Service Commission, 130 Kan 777, 288 P.755 (1930).

[16] Id. See also Docket Nos. 172-745 and 174-155-U, Nov. 15, 1991 Order and Docket No 97-WSRE-676-MER, Sept. 28, 1999 Order on Merger Application.

II. ANALYSIS:

A. Technical, Managerial, and Financial Qualifications

Pursuant to K.S.A. 66-2005(w), the Commission must determine whether CCHI, as the new owner of the RLECs and STLD, has the "technical, managerial, and financial viability" to operate and maintain the Companies' assets and operations in an efficient and sufficient manner.

FRP has approximately 2,600 employees, including five located at Sunflower's Dodge City, Kansas, headquarters to support Sunflower and STLD's operations. Twenty-three employees located in Missouri support FairPoint-MO and Bluestem's operations.[17]

Value-Line Investment Survey provides the following summary of CCHI's business:[18]

> **BUSINESS:** Consolidated Communications Holdings, Inc. provides communications services to residential and business customers in 11 states, including Illinois, Pennsylvania, Texas, and California. The company offers local and long distance service, custom calling features, private line services, dial-up and high-speed Internet access, digital TV, carrier access services, network capacity services over its regional fiber optic network, and directory publishing. It also operates telemarketing, order fulfillment, telephone services to county jails and state prisons, and mobile services. Acquired Enventis Corp., 10/14; SureWest, 7/12. CEO & President: Bob Udell. Inc.: Delaware. Address: 121 South 17th Street, Mattoon, Illinois 61938-3987. Tel.: (217) 235-3311. Internet: www.consolidated.com.

CCHI has an extensive history in the telecommunications industry; tracing its roots in the industry back to the early 1900's. In 2005, CCHI became publicly traded.[19] In that time, CCHI has been profitable and paid an annual dividend to shareholders. By 2016, CCHI served 1,037,061 customers with voice, data, and video connections.[20] CCHI's subsidiary, CCES, operates in Kansas as a CLEC, IXC, and video service provider. CCHI and its subsidiaries employ approximately 1,800 employees, including 146 located in Kansas. CCHI states that although it has not finalized its post-Transaction employment plans, it will maintain personnel at sufficient levels to maintain its ETC obligations, regulatory and contractual commitments, and Quality of Service requirements.[21]

CCHI is knowledgeable of the telecommunications and public utility industry as demonstrated through its years of experience of managing profitable operating telecommunications businesses in the United States. CCHI's operational experience, coupled with its intent to staff its operations at a level to maintain its statutory and regulatory obligations is sufficient to satisfy the managerial and technical aspects of the threshold issue. CCHI states that it does not plan to change the Kansas staffing levels or make changes at Sunflower's headquarters located in Dodge City, Kansas.[22]

CCHI will use net cash from operations to finance any new advanced services and, if temporary financing needs arise, CCHI has a $110 million revolving credit line.[23] CCHI possesses the financial qualifications necessary to own, operate and maintain the three Kansas RLECs and

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[17] Joint Application, p. 3.
[18] CCHI, Value-Line Investment Survey, March 17, 2017; www.valueline.com.
[19] Ibid.
[20] CCHI 2016 SEC Form 10-K, filed March 3, 2017, p. 3.
[21] Response to Staff DR 7(d).
[22] Response to Staff DR 8.
[23] Response to Staff DR 4(c).

STLD. It is noteworthy that CCHI has a stronger financial history than FairPoint, as discussed in more detail in the Merger Standards analysis.

B. Quality of Service Standard Qualifications

CCHI will be responsible for ensuring the RLECs meet the Commission's Quality of Service Standards.[24] CCHI states it will maintain personnel at sufficient levels to maintain its ETC obligations, regulatory and contractual commitments, and Quality of Service requirements.[25]

The RLECs have historically met their Quality of Service obligations and have not been in jeopardy or non-compliance status. CCHI should be able to continue to meet the Commission's Quality of Service standards for the RLECs; however, if an RLEC fails to meet its Quality of Service obligations, the Commission could assess penalties to the RLEC for its non-compliance consistent with its current practices.

C. Merger Standards to Evaluate the Public Interest Standard

The proposed Transaction affects the three Kansas RLECs and STLD and the Companies' ability to provide telecommunications services to approximately 3,000 subscribers. Therefore, in tandem with the evaluation of CCHI's managerial, technical, and financial qualifications, the Joint Applicants and Staff viewed the proposed Transaction in light of the Merger Standards, as follows:

a. The effect of the transaction on customers, including:
    i. The effect of the proposed transaction on the financial condition of the newly created entity as compared to the financial condition of the stand-alone entities if the transaction did not occur;
    ii. Reasonableness of the purchase price, including whether the purchase price was reasonable in light of the savings that can be demonstrated from the merger and whether the purchase price is within a reasonable range;
    iii. Whether ratepayer benefits resulting from the transaction can be quantified;
    iv. Whether there are operational synergies that can justify payment in excess of book value; and
    v. The effect of the proposed transaction on the existing competition.
b. The effect of the transaction on the environment.
c. Whether the proposed transaction will be beneficial on an overall basis to state and local economies and to communities in the area served by the resulting public utility operations in the state. Whether the proposed transaction will likely create labor dislocations that may be particularly harmful to local communities, or the state generally, and whether measures can be taken to mitigate the harm.

[24] Docket No. 95-GIMT-047-GIT, May 23, 2008 Order Modifying Quality of Service Standards to Include Consideration of Acts Beyond a Company's Control or *Force Majeure* Event.
[25] Response to Staff DR 7(d).

d. Whether the proposed transaction will [preserve] the jurisdiction of the KCC and the capacity of the KCC to effectively regulate and audit public utility operations in the state.
e. The effect of the transaction on affected public utility shareholders.
f. Whether the transaction maximizes the use of Kansas energy resources.
g. Whether the transaction will reduce the possibility of economic waste.
h. What impact, if any, the transaction has on public safety.

The Merger Standards assist in determining whether a proposed transaction provides a net benefit to ratepayers, shareholders, and the public generally and thereby, "promotes the public interest." In most merger and acquisition cases involving utilities under the full economic and rate regulation of the Commission, the appropriate focus for this standard is whether the transaction results in benefits for the public that can be quantified. The Commission has recognized that with regard to evaluating a proposed Transaction in light of the Merger Standards, "some factors may be less relevant than others to the present proceeding."[26]

The Joint Applicants provided their views of the Merger Standards as related to the Transaction in the Joint Application, the Attachments, and the Direct Testimony of Michael J. Shultz, Vice President of Regulatory and Public Policy of CCHI. Staff's Report includes the Joint Applicants' position on each Merger Standard, Staff's analysis of the Joint Applicant's position, and Staff's recommendation regarding whether the proposed Transaction meets the Standard.

(a) The effect of the transaction on consumers, including:

(i) The effect of the proposed transaction on the financial condition of the newly created entity as compared to the financial condition of the stand-alone entities if the transaction did not occur.

Applicants Response:

The Joint Applicants submit CCHI has been and will continue to be financially sound after the Transaction and that the Transaction improves FRP's financial position as compared to its existing stand-alone situation.[27]

Staff's Response:

Staff agrees with the Joint Applicant's statements regarding this Merger Standard. Staff's evaluation of this Standard found several benefits directly related to this Transaction that result in measurable improvements from FRP's financial health as a stand-alone entity. There is evidence that the Transaction meets the public interest test largely due to the improvement in financial health of FRP and, as a result, the Kansas RLECs and STLD.

Table 1, below, shows prior to the Transaction, FRP possesses a rating of B2/B (Moody's/S&P) and CCHI has a rating of B1/B+, one-notch higher than FRP's ratings. That positive difference

[26] Docket No. 13-BHCG-509-ACQ, Oct. 3, 2013 Order Approving Joint Application, ¶ 38.
[27] Shultz Direct, p. 13, ln 1-21.

is even more pronounced with regard to specific ratings on CCHI's secured debt, which is rated Ba3/BB-; a two-notch advantage over FRP's current rating. Upon announcement of the Transaction, the credit-rating agencies issued specific statements expressing their views of the Transaction's effect on credit quality. Generally, the rating agencies expressed the Transaction would not cause a downgrade to CCHI's ratings and FRP's rating was placed on credit-watch positive by S&P.

As shown in Table 1, Moody's and S&P summarized their expectations, post-Transaction, that CCHI's credit-rating will be "stable" after the Transaction, expectations that are noteworthy since the acquiring party is often put on a "negative-watch". A "negative-watch" designation is not a downgrade, but it indicates that the proposed transaction could stress the acquirer's credit quality.[28]

Table 1

Credit Ratings Related to Consolidated Comm. Holdings' Acquisition of FairPoint Communications

	Moody's		S&P	
FairPoint Communications	B2 stable family rating	(2)(4)	B positive	(5)
Consolidated Communications Holdings	Ba3 affirmed term loan	(1)	BB- issuance level; Sr. Sec	(3)
	B1 stable family rating	(2)	B+ stable family rating	(3)

Sources:
1) Moody's Investor Services; Ratings Action Moody's assigns Ba3r rating to Consolidated Communications' Term Loan; Global Credit Research; December 15, 2016.

2) Moody's Investors Services; Announcement: Moody's Says Consolidated's Planned Acquisition of FairPoint Does Not Impact the Rating of Either Company; December 5, 2016.

3) Consolidated Communications Inc's Proposed $935 Million Senior Secured Term Loan rated 'BB-'; S&P Global Ratings; December 13, 2016.

4) FairPoint Communications, Inc.; Moody's Credit Opinion; February 3, 2017. (KCC Data Request #1; 17-SFLT-283-ACQ)

5) FairPoint Communications Ratings Placed on CreditWatch Positive on Pending Acquisition By Consolidated Communications; S&P Global Ratings; December 5, 2016. (KCC Data Request #1; 17-SFLT-283-ACQ)

Part of the reason the Transaction does not harm CCHI's credit quality is that the Transaction is a stock-for-stock transaction and, therefore, CCHI will not issue debt to acquire FRP's common stock. The absence of any additional leverage is beneficial in that it enables CCHI to reduce its consolidated leverage ratio with the acquisition of FRP.[29] The benefit of CCHI's higher credit quality over FRP's will be immediately evident after the Transaction since CCHI will refinance FRP's existing debt at lower interest rates than those that have been available to FRP. CCHI will refinance FRP's 7.50% interest rate term loan and FRP's 8.75% interest rate notes with 4.00% interest rate debt.[30] The Joint Applicants also demonstrate improvement in the terms and conditions of the credit facility available after the close of the Transaction including: lower

[28] Response to Staff DR 1.
[29] Response to Staff DR 10.
[30] Shultz Direct, p. 14.

interest costs, less stringent financial covenants, and expanded borrowing capacity.[31] The replacement credit facility requires that the Kansas RLECs guarantee and pledge their assets.[32] This change appears to be a small modification from the current situation in which all of the common stock of the Kansas RLECs is pledged as collateral for FRP's current credit facility [33] and will not diminish the benefits from the improved financial health.

The RLECs do not receive KUSF support[34] and, as a result of K.S.A. 66-2005(c) and FCC reforms, their local rates will not be reduced as a result of this Transaction. Staff suggests that benefits to consumers be viewed in perspective of other non-monetary benefits; mainly the improved financial health of the CCHI. Kansas customers will benefit by being served by a financially stronger company that will be in a better position to offer updated facilities and expanded services than were provided by FRP. And, if one of the RLECs qualifies to receive KUSF support in the future, the reduction in the cost of debt will benefit the RLEC's subscribers and all contributors to the KUSF in a direct and quantifiable way.

> ***(ii) Reasonableness of the purchase price, including whether the purchase price was reasonable in light of the savings that can be demonstrated from the merger and whether the purchase price is within a reasonable range.***

Applicants Response:

The Joint Applicant's point to the analysis in Attachment B of their Application that contains an analysis of control premiums paid on other transactions in the telecommunications services industry since 2012. The Joint Applicants place the control premium paid to FRP's shareholders at 17.3%, noting the control premium is well within the range paid in past transactions.[35] The Joint Applicants forecast the Transaction will result in an estimated $55 million in annual savings and synergies.[36]

Staff's Response:

The Joint Applicants do not tie the expected savings to the implied offer price of $17.00 per share and have not provided specifics underlying the $55 million of potential annual savings. The savings are, instead, based on FRP's cost structure and CCHI's historical savings arising from past mergers and acquisitions.[37] CCHI states savings will be derived from a reduction in corporate overhead, network, and operational costs,[38] with approximately $45 million of savings arising from reductions in operating costs and $10 million resulting from third-party cost-reductions.[39] Cost savings will likely occur as a result of FRP and CCHI not serving any

[31] Response to Staff DR 11.
[32] Shultz Direct, p. 13.
[33] FRP SEC Form 10-K for 2015, p. 75.
[34] Docket Nos. 01-BSTT-878-AUD and 01-SFLT-879-AUD, May 2, 2003 Order Approving Stipulated Settlement and Agreement and Docket 06-858, June 6, 2006 Order and Certificate
[35] Shultz Direct, p. 15, 23; Attachment B.
[36] FRP SEC Form 425; filed by CCHI; Dec. 5, 2017; slide 5.
[37] Response to Staff DR 7.
[38] Shultz Direct p. 16, ln 22 - p. 17, ln 17.
[39] Id., p. 23, ln 15-18.

overlapping territory, with CCHI intending to connect its network with FRP's network via 10 gigabyte per second (Gbps) links and consolidate uplinks and cybersecurity functions.[40]

The stock-for-stock structure of the Transaction causes less concern about the premium paid for FRP since the purchase price paid for FRP is not a fixed dollar value; instead, it is a ratio of 0.73 of a share of CCHI common stock for each share of FRP, allowing the premium to fluctuate as CCHI's stock price fluctuates. As an all-stock transaction, there is no debt obligation or additional leverage tied to the payment made to FRP shareholders, thereby reducing Staff's concern regarding the amount of the control premium relative to the potential savings because the shareholders of CCHI (including the shareholders of FRP) are entirely responsible for the premium paid to acquire FRP. Furthermore, CCHI states none of the control premium will be allocated to the Kansas RLECs or STLD; therefore, ratepayers will not see any rate increases as a result of the Transaction.[41] The Transaction is the sale of an entire company, with a significant portion of the value derived from non-regulated operations. This means the Commission does not need to address a gain on the sale of assets.[42]

CCHI states it will not seek recovery of a premium from ratepayers and that the premium will be financed by CCHI equity and completely excluded from ratepayer recovery. To ensure the premium is not recovered from Kansas ratepayers, whether through rates or the KUSF, Staff recommends that CCHI's statement be formalized in the Order approving the Transaction.

(iii) Whether ratepayer benefits resulting from the transaction can be quantified.

Applicants Response:

The Joint Applicants maintain customers will benefit from advanced products and services, customer experience, and the forecasted $55 million in annual savings.[43] CCHI states none of the acquisition premium will be allocated to the RLECs and that their ratepayers will not experience rate increases as a result of the Transaction[44] beyond those needed to meet the FCC's requirements as set forth in the *USF/ICC Transformation Order*.[45]

Staff's Response:

The Joint Applicants state the RLECs and STLD will benefit via the Transaction through an estimated $55 million of annual company-wide corporate overhead, operational, and network savings achieved within two years of closing.[46] While the Joint Applicants have not identified state-specific or specific savings beyond broad categories, consumers will benefit from being served by a more financially stable company. Additionally, there are quantifiable financial benefits associated with the reduction in interest expense CCHI will experience as a result of

[40] Shultz Direct, p. 17, ln 1-11.
[41] Id., p. 15, ln 21-23.
[42] Docket No. 04-UTDT-781-CCS, Dec. 27, 2004 Order Approving Stipulation and Agreement and Canceling Certificate Effective Upon the Consummation of the Sale of Exchanges.
[43] Shultz Direct, p. 16, ln 1-3, 13-21.
[44] Id., p. 15, ln 21 - 23.
[45] *USF/ICC Order*, ¶ 133-138.
[46] Shultz Direct, p. 15; response to Staff DR 7.

refinancing RFP's outstanding debt, although the immediate customer benefits are difficult to quantify since the RLECs do not receive KUSF support.

CCHI states local rates will not increase as a result of the Transaction. As a price cap carrier in the federal jurisdiction, FRP will not increase local residential rates to meet the FCC's rate floor requirements. Furthermore, FCC's rules provided for in Section 61.41, known as the "all-or-nothing" rule, require a carrier and its affiliates to operate under the same form of regulation, whether it is price cap or rate-of-return regulation. Section 61.41(c)(2) requires that, when a price cap and rate-of-return carrier merge or acquire one another, the rate-of-return carrier convert to price cap regulation within one year of the transaction.[47] CCHI filed a waiver with the FCC requesting §64.41 forbearance [48] to allow the RLECs "to be acquired without changing any of their day-to-day operations, pricing, or other terms of service. . . ."[49] The FCC issued a Public Notice establishing the comment cycle on the Waiver Application on January 12, 2017.[50] Comments and Petitions were due February 13, 2017, and Reply Comments or Opposition Petitions were due February 28, 2017. No Comments, Petitions, Reply Comments or Opposition Petitions were filed on the Waiver Application.

Given that no petitions or objections were filed against the Waiver Application, Staff expects the FCC to grant the request. Upon granting of the forbearance waiver, the RLECs will continue to operate under rate-of-return regulation in Kansas. This means they will remain subject to the intrastate access rate parity and local service rate requirements pursuant to K.S.A. 66-2005(c) and (e). In addition, if an RLEC submits a request for KUSF support, the determination of such support will include an adjustment for the RLEC's local rates since the three RLECs' rates are, in general, below the statewide affordable residential and single-line business rates of $17.25 and $20.25,[51] respectively, as shown in Table 2:

Table 2

Company	Residential Rate	Single-Line Business Rate
Bluestem[52]	$ 16.74	$ 21.04
FairPoint-MO[53]	$ 15.00	$ 18.00
Sunflower[54]	$ 13.27	$ 16.93

Another non-quantifiable benefit is that CCHI states it will offer advanced services to consumers and connect the RLECs and STLD to its fiber network via 10 Gbps links to promote improved

[47] 47 C.F.R. 61.41(c)(1) and (c)(2).

[48] *In the Matter of the Joint Application of Consolidated Communications Holdings, Inc., And FairPoint Communications, Inc., for authority pursuant to Section 214 of the Communications Act of 1934, as amended, to Transfer Indirect Control of Domestic and International Section 214 Authorization Holders to Consolidated Communications Holdings, Inc.*, WC Docket No. 16-417, filed Dec. 21, 2016.

[49] Joint Application, Exhibit C Public Interest Statement, IV, p. 15.

[50] Public Notice, Pleading Cycle Established, WC Docket No. 16-417, rel. Jan. 12, 2017, last viewed April 17, 2017, at: https://apps.fcc.gov/edocs_public/attachmatch/DA-17-52A1.pdf.

[51] Docket 17-008, Jan. 19, 2017 Order Adopting KUSF Assessment and Affordable Local Service Rates.

[52] Id., Bluestem Telephone Company KUSF Annual Update, filed Oct. 19, 2016.

[53] Id., FairPoint Communications Missouri, Inc. KUSF Annual Update, filed Oct. 19, 2016.

[54] Id., Sunflower Telephone Company KUSF Annual Update, filed Oct. 19, 2016

broadband and video speeds and offer more network stability and security.[55] CCHI states it will "offer advanced products and services and consumer choice for telecommunications and broadband services in the service areas of the FairPoint LECs,"[56] as its company engineering policy includes expanding the central office to the last mile via deployment of Fiber to the Curb (FTTC) and employs a Fiber to the Home (FTTH) design for all new greenfield areas. This contrasts with FRP making minimal investments in the RLECs during the past five years, as shown below:

Total RLECs - Combined

	2012	2013	2014	2015	2016
Gross Intrastate Regulated Plant	$36,293,210	$37,651,336	$ 37,650,828	$ 37,690,454	$ 36,800,531
Accum. Depr.	28,315,021	30,177,565	30,917,574	31,211,251	31,196,679
Net Plant	$ 7,978,189	$ 7,473,771	$ 6,733,255	$ 6,479,203	$ 5,603,852

FRP accepted Connect America Fund (CAF) Phase I, Round II support to deploy broadband to underserved and unserved census blocks in Bluestem's study area[57] and CAF Phase II support[58] to deploy broadband to FairPoint MO's census blocks. FRP, however, declined CAF Phase II (CAF II) support for qualifying census blocks in Sunflower and Bluestem's study areas;[59] meaning at least 18 census blocks in Sunflower's and 130 census blocks in Bluestem's service area do not have access to advanced broadband services[60] and will be included in the FCC's CAF II auctions.[61] CCHI states it will evaluate whether to participate in the CAF II auctions.[62] The Company has not developed specific plans regarding broadband and advanced services deployment in areas not supported by CAF II funding.[63]

(iv) Whether there are operational synergies that justify payment of a premium in excess of book value.

Applicants Response:

The Joint Applicants state, "the Transaction offers an opportunity for greater network efficiencies. As part of the anticipated merger-related synergies of $55 million to be achieved in

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[55] Shultz Direct, p. 17, ln 1-8.
[56] Id., p. 16, ln 1-3.
[57] Response to Staff DRs 5, 16.
[58] WC Docket No. 10-90 et al., Wireline Competition Bureau Public Notices dated Dec. 5, 2013, and Dec. 19, 2016; FRP's Feb. 24, 2015, letter from Karen Brinkmann to Marlene H. Dortch, Secretary, FCC, and response to Staff DR 5.
[59] WC Docket No. 10-90, Letter from Paul H. Sunu, Chief Executive Officer, FairPoint Communications, Inc., to Marlene H. Dortch, Secretary, FCC, filed Aug. 18, 2015.
[60] The FCC's preliminary CAF II auction census block map and preliminary list of eligible census blocks may be viewed at: https://www.fcc.gov/maps/caf-2-auction-preliminary-areas/ and https://transition.fcc.gov/wcb/Prelim_Phase_II_Auction_Eligible_CBs_081016.zip.
[61] WC Docket No. 10-90, Report and Order and Order on Reconsideration, rel. March 2, 2017.
[62] Response to Staff DR 16.
[63] Response to Staff DRs 4, 16.

two years, the parties expect at least $10 million of that to be attributed to network access synergies."[64] The Joint Applicants did not address the net book value of the RLEC properties; however, CCHI states it will not recover any of the premium from ratepayers.

Staff's Response:

As discussed earlier, the Joint Applicants have not provided a nexus between the estimated $55 million of annual savings and the price negotiated for FRP as it relates to the net book value of the assets. As a stock-for-stock transaction resulting in no additional leverage for the newly created company, Staff is less concerned about the stock value payment above book value than if FRP shareholders received cash for their shares since the actual share value and Transaction price will be determined on the date of closing.

Additionally, a significant portion of FRP and CCHI's revenue and value is tied to non-regulated operations. This fact renders a comparison of the purchase price for this company to its book value of equity (or assets) less relevant than if FRP was a fully-regulated entity. As of the year-ended December 31, 2016, FRP's current book value of equity is a negative $54 million[65] compared to its net property, plant and equipment of $1.024 billion. It is extremely unlikely a fully-regulated utility would have such a significant disparity between the value of its assets and its book value of equity. This highlights the difficulty of applying this Merger Standard (which was developed for the review of a merger between two fully rate regulated entities) to a Transaction in which a significant portion of the value in the target company relates to its non-regulated operations. Even so, Staff has evaluated how the Transaction purchase price compared to the book value of FRP and how that relates to the savings that CCHI anticipates.

The Transaction calls for .73 shares of CCHI stock for every 1 FRP share. As of Monday, April 10, 2017, CCHI was trading for $23.89, or a value of approximately $17.43 per share for every FRP share. This equates to a total purchase price of approximately $472 million when multiplied by the number of outstanding FRP shares.[66] When compared to the book value of FRP's equity, it suggests an approximate premium over book value of $526 million. If the estimated $55 million of annual synergies identified by CCHI and an estimated $36 million of annual interest expense savings are considered, a premium of this magnitude can be justified rather easily on a net present value basis, even if FRP's synergy estimates don't materialize quite as expected.[67]

(v) The effect of the proposed transaction on the existing competition.

Applicants Response:

The Joint Applicants state no overlapping properties exist between CCHI's properties and FRP's Kansas properties and, therefore, the Transaction will not reduce the number of competitors in

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[64] Shultz Direct, p. 17.

[65] http://phx.corporate-ir.net/phoenix.zhtml?c=122010&p=irol-SECText&TEXT=aHR0cDovL2FwaS50ZW5rd2l6YXJkLmNvbS9maWxpbmcueG1sP2lwYWdlPTExNDQ5MTczJkRTRVE9MCZTRVE9MCZTUURFU0M9U0VDVElPTl9FTlRJUkUmc3Vic2lkPTU3.

[66] There were 27.074 million FRP shares outstanding as of Dec. 31, 2016.

[67] At a 9% WACC, $91 million in annual cost savings for ten years equates to a Net Present Value of $584 million.

the telecommunications industry within Kansas.[68] The Joint Applicants state CCHI's acquisition could (or will) likely result in new services, such as video services, to FRP's markets. CCHI states indicates it will improve broadband capacity through linking CCHI's network with the RLEC networks, allowing CCHI to better compete with cable and wireless providers.[69]

<u>Staff's Response:</u>

CCHI and FRP do not serve overlapping territories in Kansas, meaning the Transaction will not result in any currently serviced areas being merged. The RLECs do not receive KUSF support and KUSF support for competitive eligible telecommunications carriers is being phased-out and will be eliminated effective March 1, 2018.[70] Any competitive providers, regardless of technology used, should not be negatively impacted by the Transaction. Staff is not concerned that the Transaction will have any detrimental effect on competition within the RLEC service areas.

(b) The effect of the transaction on the environment.

<u>Applicants Response</u>:

The Joint Applicants note that CCHI has a formalized environmental policy as part of its corporate culture.

<u>Staff's Response:</u>

It is Staff's opinion that this particular Merger Standard plays only a minor role in evaluating the public interest of a telecommunications merger as the industry is not subject to environmental regulation to the degree that natural gas and electric utilities are.

(c) Whether the proposed transaction will be beneficial on an overall basis to state and local economies and to communities in the area served by the resulting public utility operations in the state. Whether the proposed transaction will likely create labor dislocations that may be particularly harmful to local communities, or the state generally, and whether measures can be taken to mitigate the harm.

<u>Applicants Response</u>:

In general terms, the Joint Applicants state that CCHI expects to make capital investments in its LECs in the future that will benefit the RLEC communities. The Joint Applicants state CCHI has refrained from making specific commitments to the level or pace of investment in any particular market because of the unpredictability of state and federal regulation and volatility in the telecommunications market place.[71] CCHI states that it will, however, continue the RLECs' historical community commitments.[72]

[68] Shultz Direct, p 17, ln 14-15.
[69] Id., p. 17, ln 18 - 19.
[70] K.S.A. 66-2008(c)(4).
[71] Shultz Direct, p 20, ln 5-19.
[72] Id., p. 16, ln 17; response to Staff DR 15.

Staff's Response:

This Merger Standard goes further than costs and benefits of the customers served by the utility; it looks at the communities where the utilities operate in an attempt to evaluate whether the communities will benefit from the proposed Transaction. A Company's presence in the communities serves as one measure of the public interest test, including the availability of services, the level of investment, employment, and company donations to a community. CCHI states it believes it can achieve and maintain a similar level of community donations as that previously made by FRP.[73] CCHI's statement regarding achieving and maintaining a similar level of community donations could be formalized in an Order approving the Transaction. With regard to the level of employment in the communities, as they exist today, the Joint Applicants have a minor presence in Kansas with only five positions in Dodge City at the Sunflower RLEC. The Joint Applicants state that these five positions are tasked with operations, maintenance, and equipment installations. CCHI states that no reductions are expected of these five individuals.[74]

> ***(d) Whether the proposed transaction will preserve the jurisdiction of the KCC and the capacity of the KCC to effectively regulate and audit public utility regulations in the state.***

Applicants Response:

The Transaction will not change the Commission's authority over the RLECs, STLD, or CCES.[75]

Staff's Response:

Staff agrees with the Joint Applicants' assessment. CCHI and FRP each have subsidiaries that operate under price cap regulation and subsidiaries, including the RLECs, that operate under rate-of-return regulation. CCHI has requested a §61.41 waiver and approval of such waiver from the FCC will allow the RLECs to be purchased without changing their day-to-day operations, rates, or other terms of service.[76]

The RLECs will continue to be required to file Annual Reports, notify the Commission of any changes in their structure or operations, pay Commission assessments, meet intrastate access rate and local service rate requirements pursuant to K.S.A. 66-2005, and file tariffs. The Companies will continue to be required to report their revenues and pay the related KUSF assessments. CCHI does not have specific plans to change rates for local services and the RLECs are not subject to the FCC's local rate floor requirements.[77] The RLECs continue The RLECs and STLD will maintain their current COCs and approved tariffs.

> ***(e) The effect of the transaction on affected public utility shareholders.***

Applicants Response:

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[73] Response to Staff DR 15.
[74] Shultz Direct, p. 21, ln 14-22.
[75] Shultz Direct, p. 22, ln 1-13.
[76] Joint Application, Exhibit C Public Interest Statement, IV, p. 15.
[77] Response to Staff DR 6.

The Joint Applicant's note that the FRP shareholders will receive shares of CCHI at an implied price of $17.00 per share; the FRP shareholders will become shareholder in CCHI and are expected to receive an annual dividend.[78]

Staff's Response:

As discussed earlier, this is a stock-for-stock acquisition, with FRP shareholders becoming shareholders in CCHI, a financially stronger, more profitable, dividend paying company than FRP is as a stand-alone company. FRP shareholders voted to accept the offer from CCHI in a special meeting held March 28, 2017. CCHI shareholders voted to proceed with the acquisition of FRP at a special meeting also held on March 28, 2017.

FRP has not paid a dividend since going public in 2008. In Staff's view, it is in the "public interest" for consumers to be served by financially sound utilities; of course, such utilities are ultimately owned and financed by shareholders. If shareholders are not adequately compensated, they will not be willing to commit additional capital to fund growth and new services. From the perspective of this Merger Standard, the Transaction is in the public interest as FRP shareholders will be shareholders in a financially stronger company.

(f) Whether the transaction maximizes the use of Kansas energy resources.

Applicants Response:

The Joint Applicants note the names of the Kansas electric utilities that serve its facilities in Kansas stating that the energy resources or resource mix utilized by these electric utilities is an issue that the Commission would address in a docket involving these electric utilities.

Staff's Response:

In Staff's opinion, this Merger Standard does not provide useful evidence for the "public interest" test in acquisitions involving transactions between telecommunications companies.

(g) Whether the transaction will reduce the possibility of economic waste.

Applicants Response:

The Joint Applicants maintain that the Transaction will promote economic efficiency, reiterating their position that the Transaction will result in an estimated $55 million of annual synergies and cost savings (system wide) after two years, as well as access to lower cost capital for FRP. Thus, the Transaction meets this Merger Standard.[79]

Staff's Response:

Staff generally agrees with the Joint Applicants on this Merger Standard, with two caveats: (1) the estimated synergies and cost savings have not been subjected to substantial scrutiny and Staff has not independently verified if this is a realistic expectation; and (2) the estimated synergies

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[78] Shultz Direct, p. 22, ln 14-23.
[79] Id., p. 23, ln 11-23.

are system-wide for the entire merged company. Staff does not know if or to what extent the RLECs or STLD will receive benefits from the estimated synergies. Staff's data request seeking support and back up on the projected savings did not yield any substantive documentation on the anticipated savings;[80] however, the reduction in CCHI's cost of capital can be quantified and would be passed through to ratepayers in the event one of the RLECs files for KUSF support or requests a local rate increase in an audit or rate case in the future. Staff agrees the Transaction should help reduce the possibility of economic waste.

(h) What impact, if any, the transaction has on the public safety.

Applicants Response:

The Joint Applicants discuss their provision of 911 services through the Kansas RLECs and state that there will be no change to those services from this Transaction.

Staff's Response:

The Transaction is a stock-for-stock transaction that does not change how the RLECs interact with the Public Safety Answering Points within their service areas and will have no direct impact on the RLECs' requirements to meet their Quality of Service Standards. Staff has no concerns with regards to CCHI's ability to continue to meet required public safety standards.

RECOMMENDATION

Staff's review of the proposed Transaction supports that it will promote the public interest. CCHI is a more financially stable company than FRP and CCHI intends to connect the RLECs' networks to CCHI's network, offer new and advanced services to subscribers, and evaluate the Kansas RLEC markets in light of the FCC's CAF II support actions. Staff views the Transaction as being in the public interest and recommends the Commission approve the Transaction. Staff also recommends that the Commission formalize CCHI's statements that no portion of the acquisition premium incurred as a result of this Transaction will be recovered from Kansas ratepayers, whether through rates or the KUSF.

[80] Response to Staff DR 7.

CERTIFICATE OF SERVICE

17-SFLT-283-ACQ

I, the undersigned, certify that a true and correct copy of the above and foregoing Notice of Filing of Staff's Report and Recommendation was served by electronic service on this 1st day of May, 2017, to the following:

COLLEEN R. JAMISON
JAMES M. CAPLINGER, CHARTERED
823 SW 10TH AVE
TOPEKA, KS 66612-1618
Fax: 785-232-0724
colleen@caplinger.net

MICHAEL DUENES, ASSISTANT GENERAL COUNSEL
KANSAS CORPORATION COMMISSION
1500 SW ARROWHEAD RD
TOPEKA, KS 66604-4027
Fax: 785-271-3354
m.duenes@kcc.ks.gov

MICHAEL NEELEY, LITIGATION COUNSEL
KANSAS CORPORATION COMMISSION
1500 SW ARROWHEAD RD
TOPEKA, KS 66604-4027
Fax: 785-271-3167
m.neeley@kcc.ks.gov

RACHEL LIPMAN REIBER, ATTORNEY
RACHEL LIPMAN REIBER LLC
214 S CHESTNUT, SUITE 3
OLATHE, KS 66061
Fax: 913-782-4445
rlreiberlaw@gmail.com

Pamela Griffeth

Pamela Griffeth
Administrative Specialist