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From

UNDERSTANDING THE DEBATE OVER GOVERNMENT-OWNED BROADBAND NETWORKS:

Context, Lessons Learned, and a Way
Forward for Policy Makers

Lafayette Case Study

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Lafayette, Louisiana

The municipal fiber-optic system built in Lafayette, Louisiana, is cited as perhaps the most “legitimate” of the public-owned networks in the country. The local utility that built the network prevailed in legal challenges and a public referendum regarding whether it could use public funds to support construction.¹ As result of the referendum and legal challenges, Lafayette’s municipal system has often been cited by GONs advocates as a model for GONs in other locations. An examination of this GON identifies a clear need for policy makers, residents, businesses, and other stakeholders, both in Lafayette and elsewhere, to keep reviewing the short- and long-term prospects of this municipal broadband system.

Background

Lafayette’s fiber-optic GON began in the late 1990s with construction of a single fiber ring by the municipally owned local utility, Lafayette Utilities System (LUS). The purpose was to enhance communication across its electric network.² During the planning phase, LUS determined it could deploy a significant amount of excess capacity (i.e., eight times as many fiber strands) for only 20 percent above the original estimated cost.³ The low cost of fiber at this time was due in large part to the glut of redundant fiber-optic networks built in cities and states across the country in the last half of the 1990s. Much of this fiber remained “dark” for years, and thousands of miles remain unlit.⁴ The Lafayette City-Parish Council voted to proceed with the expanded fiber ring in 1998.⁵

By 2002, LUS was offering wholesale data services to the city government that were faster than existing offerings but priced the same.⁶ As a result, and in an effort to explore other potential uses for the network, the City Council authorized a study to examine the feasibility of using the network for non-government purposes.⁷ In 2004, the city government undertook a robust market study of possible next steps for the burgeoning LUS network.⁸ Also during this time, the Louisiana state legislature passed the Local Government Fair Competition Act, a bill that, among other things, set forth a process to guide municipalities interested in deploying a GON (including the completion of a feasibility study) and prohibited the use of cross-subsidies to support deployment of a communications networks.⁹

In the fall of 2004, LUS completed its feasibility report and brought the issue to the City Council.¹⁰ The Council voted for the sale of revenue bonds to finance the project.¹¹ Local incumbents immediately challenged these actions in court, charging that state law required a referendum before issuing bonds.¹² The court agreed, and Lafayette held a referendum in 2005. Residents voted in favor of the \$125 million bond issue by a margin of nearly two to one.¹³

Additional legal challenges followed. Citizens, incumbent ISPs, and others argued that the LUS-issued bonds were an illicit form of cross-subsidization that placed an unfair burden on taxpayers and utility customers.¹⁴ The Supreme Court of Louisiana sided with LUS in early 2007.¹⁵ Soon thereafter, LUS issued \$110 million in revenue bonds. Network construction began in 2008; by 2009, it began to connect users.¹⁶

Lafayette, Louisiana At-A-Glance



City Population: 122,761 (2012)

Year of Network Launch: Late 1990s

Current Status: Built

Number of subscribers: 14,000

Revenues: \$24 Million

Operating Expenses: \$29 Million

Note: Additional information on the Lafayette network is contained in Table 1 and in Appendix I.

Cost and Financing

The original backbone and network frame were transferred from the utility to LUS Fiber, a municipally owned subsidiary of LUS, in November 2007.¹⁷ LUS Fiber reimbursed the utility for the transfer and other startup costs. The purchase of the assets and other startup costs were funded by loans between the utility and LUS Fiber at market terms and rates.¹⁸ Although these are loans that must be repaid, LUS Fiber does not consider such loans as debts on its balance sheet.¹⁹

To date, the costs of building and maintaining the GON in Lafayette have exceeded the initial \$125 million bond authorized by referendum. More specifically, the city's first bond issuance—\$110,405,000 in communications system revenue bonds—was in 2007, followed by a second, smaller issuance—\$14,595,000—in 2011.²⁰ An additional \$7 million in bonds was issued in 2012.²¹ Furthermore, LUS Fiber took out other loans over the years and says it will continue to do so in the future. For example, LUS Fiber borrowed \$16,429,422 from the utility for “the acquisition of fiber infrastructure, startup costs, and operations.”²² In 2012, the City Council approved an additional \$5.5 million loan for LUS Fiber.²³ Taken together, the total principal of LUS Fiber's debt is in excess of \$150 million, exclusive of startup costs and fees.

While LUS Fiber is technically independent of the utility, “there is a relationship in that should LUS [Fiber] encounter a credit event or default on [its] bonds, LUS combined utilities revenues could be used to pay debt service.”²⁴ Specifically, even though LUS Fiber's structure and financing are intended to limit direct taxpayer liability, like most GONs its financing mechanisms do not completely isolate the risk. While the communications system is separate from the utilities system, “if the [former] fails to generate sufficient revenues to pay debt service for its bonds, the [latter] is required to pay the debt service.”²⁵ Thus, utilities customers are exposed to the risks associated with Lafayette's investment in municipal broadband.

The Network

The fiber-optic GON in Lafayette is fully operational. LUS Fiber offers television, broadband, and telephone service throughout the city. As of May 2013, the system had attracted 14,000 customers, about one-third of its total potential subscribers.²⁶ Its services can be purchased separately or as a bundle. The price for a 3 Mbps connection is \$19.95 per month (as part of a bundle), while its gigabit service costs \$999.95 per month.²⁷ Additional speed tiers include stand-alone symmetrical connections of 15 Mbps (\$34.95/month), 40 Mbps (\$49.95/month), 75 Mbps (\$99.95/month), or 100 Mbps (\$199.95/month).²⁸ Rates are regulated by the City Council.²⁹

A recent audit of LUS Fiber found that, while the system is generating revenues sufficient to cover its debt payments, it has been running at an overall loss for the last few years.³⁰ Including depreciation, LUS Fiber “ended 2012 with a loss of \$11,869,564, compared with a loss of \$16,519,323 in 2011.”³¹ In addition, one recent analysis suggests the system, as of just a few years ago, was losing anywhere from \$30,000 to \$45,000 a day.³² For these many reasons, the date by which the GON is expected to be fully self-sustaining has been pushed back several times, first to 2013,³³ then to 2014,³⁴ and most recently to 2015.³⁵

Beyond the unique symbiotic relationship with LUS generally, there is some evidence to suggest the communications division is a drag on the overall performance of the parent utility. Moody's, for example, noted in a recent review of LUS's revenue bonds that “LUS has a high debt ratio if telecommunications system debt is included in LUS debt ratios given LUS Combined Utilities has obligation to pay if system doesn't pay.”³⁶ Like the other GONs examined in this section, the financial stability of this GON in both the short term and long term remains uncertain and should continue to be closely monitored.

Community Impact

NuComm International in 2006 promised to bring 1,000 new jobs to Lafayette by building an expansive call center near the city.³⁷ NuComm management said the presence of the GON had a major influence on its decision, along with several monetary enticements from local government (including \$1 million from the state's Rapid Response economic development program and another \$1 million from the Lafayette Economic Development Authority).³⁸ The center, which employed an average of 495 employees, suffered massive layoffs in 2009 and eventually closed.³⁹

Another company that relocated is Pixel Magic, a special effects company that opened a satellite office in Lafayette in 2009.⁴⁰ The company was solicited via an aggressive campaign by state officials, which included an array of tax breaks, free office space, and other non-financial incentives (e.g., employee recruiting services).⁴¹ According to a company official, "Pixel Magic chose Louisiana because of its variety of locations, the growth of the film industry in the state and its lucrative tax breaks for film production and digital media."⁴² The firm, which typically hires on a project-to-project basis, tends to employ anywhere from 100 to 200 people.⁴³

In general, the local economy remains dominated by the energy and healthcare industries, which account for about 40 percent of all economic activity.⁴⁴ Moreover, its proximity to the coast and other transportation hubs has made it an attractive destination for a range of non-high-tech trade industries, tourism, and hospitality.⁴⁵ Despite many efforts to date, very few tech-oriented companies in the area outside the thousands of workers employed by incumbent ISPs like Cox and AT&T employ more than a few dozen people.⁴⁶

Assessment

A notable feature of the Lafayette GON is the significant amount of debt that accrued during the construction of the network. As discussed in **section 3**, debt of any size, especially during such volatile economic times, is of concern to municipal and state governments. In the case of Lafayette, this concern is acute given that its GON has not yet become financially self-sustaining and, after investing more than \$150 million, the network has attracted only 14,000 subscribers (there are 48,800 in Lafayette, Louisiana⁴⁷).

There is continued debate about the investment in the Lafayette GON in light of other pressing local priorities. The Lafayette budget has been in flux in recent years. Although it was able to squeeze \$18 million in savings in 2012 (due in large part to a massive hiring freeze),⁴⁸ the local school system has faced a number of budget challenges in recent years, some of which have threatened the elimination of jobs.⁴⁹ In addition, recent spending cuts forced the local government to prioritize spending in ways that have led to neglect of key local infrastructure like roads and drainage.⁵⁰

Additional Infrastructure Needs in Louisiana

In the aggregate, cuts in funding to maintain local infrastructure contribute to the overall crumbling nature of roads, bridges, dams, and other such structures throughout the state. Nearly two-thirds of the roads in Louisiana are of poor or mediocre quality.⁵¹ Similarly, failure to address school budget gaps, along with prioritizing bond issuances in support of a GON instead of school construction, has contributed to a \$7 billion shortfall in school infrastructure funding throughout the state.⁵²

Endnotes

- 1 See, e.g., Rick Jervis, *Louisiana City Blazes High-Speed Web Trail*, Feb. 5, 2012, USA Today, available at <http://usatoday30.usatoday.com/news/nation/story/2012-02-01/broadband-telecom-lafayette/52920278/1> (providing relevant background information regarding the construction of this GON) (“*Louisiana City Blazes High-Speed Web Trail*”).
- 2 See LUS Fiber, History, <http://www.lusfiber.com/index.php/historical-timeline>.
- 3 *Broadband at the Speed of Light* at p. 17.
- 4 For a discussion of the conditions that led to the “glut,” see Rebecca Blumenstein, *How the Fiber Barons Plunged the U.S. into a Telecom Glut*, June 18, 2001, Wall St. Journal.
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- 6 *Broadband at the Speed of Light* at p. 17.
- 7 *Id.* at p. 18.
- 8 *Id.*
- 9 See Local Government Fair Competition Act, ACT No. 736, Louisiana Legislature (Reg. Session 2004), available at <http://www.legis.la.gov/legis/ViewDocument.aspx?d=820786>.
- 10 *Broadband at the Speed of Light* at p. 20.
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- 14 See, e.g., *Elizabeth W. Naquin et al. v. Lafayette City Parish Consolidated Government*, No. 2006-C-2227 (Sup. Ct. of La., Feb. 22, 2007), available at <http://www.lasc.org/opinions/2007/06C2227.opn.pdf>.
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- 16 *Broadband at the Speed of Light* at p. v.
- 17 See *Utilities Revenue Refunding Bond, Series 2012, City of Lafayette Louisiana*, at p. 42, Electronic Municipal Market Access, Municipal Securities Rulemaking Board (2010), available at <http://emma.msrb.org/EA494408-EA384388-EA781227.pdf> (“*Utilities Revenue Refunding Bond, Series 2012, City of Lafayette Louisiana*”).
- 18 *Id.*
- 19 See *Communications System Revenue Bond, Series 2012, City of Lafayette Louisiana*, at p. 39, Electronic Municipal Market Access, Municipal Securities Rulemaking Board (2011), available at <http://emma.msrb.org/ER539796-ER417759-ER819677.pdf>.
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- 21 See Dan Aschenbach, *Moody's Assigns A1 to Lafayette, Louisiana Combined Utility Revenue Bonds; Outlook Stable*, Nov. 26, 2012, Moody's, available at http://www.moody.com/research/Moodys-Assigns-A1-to-Lafayette-Louisiana-Combined-Utility-Revenue-Bonds-New-Issue--NIR_900823593 (“*Moody's Assigns A1 to Lafayette, Louisiana*”).
- 22 *Utilities Revenue Refunding Bond, Series 2012, City of Lafayette Louisiana* at p. 43.
- 23 See, e.g., Richard Burgess, *Official: LUS Fiber Taking Off*, Aug. 24, 2012, The Advocate, available at <http://theadvocate.com/home/3632694-125/official-lus-fiber-taking-off> (“*LUS Fiber Taking Off*”).
- 24 *Moody's Assigns A1 to Lafayette, Louisiana*.
- 25 See *Electric Revenue Bond, Series 2012, Lafayette Public Power Authority*, at p. 54, Electronic Municipal Market Access, Municipal Securities Rulemaking Board (2012), available at <http://emma.msrb.org/ER634382-ER491088-ER893967.pdf>. (“*Electric Revenue Bond, Series 2012, Lafayette Public Power Authority*”).
- 26 See Richard Burgess, *LUS Announces Number of Subscribers*, May 29, 2013, The Advocate, available at <http://theadvocate.com/news/6038657-123/lus-announces-number-of-subscribers> (“*LUS Announces Number of Subscribers*”).
- 27 See LUS Fiber, Pricing, <http://lusfiber.com/index.php/package-price-internet>.
- 28 *Id.*
- 29 *Moody's Assigns A1 to Lafayette, Louisiana*.
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- 33 *Moody's Assigns A1 to Lafayette, Louisiana*.
- 34 *LUS Fiber Taking Off*.
- 35 *LUS Announces Number of Subscribers*.
- 36 *Moody's Assigns A1 to Lafayette, Louisiana*.
- 37 See LUS Fiber, History, available at, <http://www.lusfiber.com/index.php/historical-timeline>. *Broadband at the Speed of Light* at p. 30.
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- 46 *Id.*
- 47 See Census Bureau, State and County Quick Facts, Lafayette (city), Louisiana, <http://quickfacts.census.gov/qfd/states/22/2240735.html>.
- 48 See Richard Burgess, *Lafayette Sees Bigger Fund Balance*, May 29, 2013, The Advocate, available at <http://theadvocate.com/news/6099240-123/lafayette-sees-bigger-fund-balance> (“*Lafayette Sees Bigger Fund Balance*”).
- 49 See Charles Lussier, *School Board Delays Vote on Budget*, July 19, 2013, The Advocate, available at <http://theadvocate.com/home/6527575-125/school-board-delays-vote-on>.
- 50 *Lafayette Sees Bigger Fund Balance*.
- 51 See ASCE 2013 Infrastructure Report Card, States—Louisiana, <http://www.infrastructurereportcard.org/a/#p/state-facts/louisiana>.
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