

LOUISIANA PUBLIC SERVICE COMMISSION

ORDER NUMBER U-34830

LOUISIANA PUBLIC SERVICE COMMISSION, EX PARTE

Docket No. U-34830, In re: Audit of Lafayette Utilities System's Covered Services under General Order of the Louisiana Public Service Commission dated October 4, 2005 for the years 2016-2017.

(Decided at the March 17, 2021 Business and Executive Session.)

ORDER

I. OVERVIEW

In 2004, the City of Lafayette announced its proposal for a municipal fiber network that would provide broadband internet, cable television, and telecommunications services to residents and businesses throughout its service territory. The decision of the Lafayette Consolidated Government ("LCG") to enter into competitive lines of business through its Lafayette Utilities System ("LUS") division prompted the state legislature to modify an existing bill in order to establish rules that would introduce some regulation over a municipal entity when it offers products and services in competition with the private sector. The passage of the modified legislation allows LUS to offer its competitive video, broadband internet, and telecommunications services – referred to as "covered services" – under the provisions of La. R.S. 45:844.41, *et seq.* (the "Fair Competition Act").

Pursuant to La. R.S. 45.844.55.D, the Louisiana Public Service Commission ("LPSC" or "the Commission") is charged with the responsibility and granted the authority to "adopt rules to define and govern equitable cost allocation as well as safeguards to govern affiliate or inter-company transactions." The Commission's responsibility and authority under the Fair Competition Act also extends to the area of compliance with its cost allocation rules and affiliate transaction safeguards. La. R.S. 45:844.55.D.(1) states that "For covered services within the jurisdiction of the Louisiana Public Service Commission, enforcement of cost allocation and affiliate transaction rules shall be by the Louisiana Public Service Commission." As such, a set of cost allocation and affiliate transaction rules for local governments' provision of competitive services were established in the Commission's General Order dated October 4, 2005 (Docket No. R-28270) (the "General Order").

LUS operates on a fiscal year that begins on November 1st and continues through October 31st of the following year. The Commission retained Henderson Ridge Consulting to perform the initial audit of LUS' compliance with the requirements of its General Order for fiscal years 2008, 2009, and 2010.¹ Henderson Ridge Consulting was retained to conduct a subsequent compliance audit of LUS' covered services for fiscal year 2011.² The scope of the subsequent audit was expanded to include fiscal year 2012 in August 2013.

At the April 18, 2018 Business and Executive Session ("B&E"), the Commission directed Staff to open an audit of Lafayette Utilities Systems' covered services under the General Order for the years 2016-2017. On May 4, 2018, Staff issued a *Notice of Audit* pursuant to that directive, and the *Notice* was published in the Commission's Official Bulletin on the same day, for informational purposes only. As in the prior two compliance audits, the areas examined by Henderson Ridge Consulting (together with Commission Staff, "Staff") in the course of the third audit tracked the principal sections of compliance requirements as found in the Commission's General Order. LUS' compliance with each rule and requirement as it relates to the following areas was tested and confirmed: (a) Allocation of Costs, (b) Transactions with Affiliates, (c) Balance Sheet Accounting, (d) Allocation of Revenue and Expenses, (e) Imputation of Taxes, Fees, and Other Assessments, (f) Time Reporting Procedures, (g) Code of Conduct, and (h) Reporting Requirements. The scope of the current audit was limited to the fiscal year 2017 financial transactions of LCG and LUS.

II. JURISDICTION

Article IV, Section 21 of the Louisiana Constitution of 1974 provides the Commission with the following authority:

- B. Powers and Duties. The Commission shall regulate all common carriers and public utilities and have such other regulatory authority as provided by Law. It shall adopt and enforce reasonable rules, regulations and procedures necessary for the discharge of its duties, and shall have other powers and perform other duties *as provided by Law* (emphasis added).

¹ The initial audit was assigned Docket No. U-32225.

² The subsequent audit was assigned Docket No. U-32911.

Pursuant to La. R.S. 45:844.55.D, the Commission is charged with the responsibility and was granted the authority to “adopt rules to define and govern equitable cost allocation, as well as safeguards to govern affiliate or inter-company transactions.” The Commission’s responsibility and authority under the Fair Competition Act also extends to the area of compliance with its cost allocation rules and affiliate transaction safeguards. La. R.S. 45:844.55.D(2) states:

For covered services within the jurisdiction of the Louisiana Public Service Commission, enforcement of cost allocation and affiliate transaction rules shall be by the Louisiana Public Service Commission.

At its September 14, 2005 Business and Executive Session, the Commission approved a set of cost allocation and affiliate transaction rules for local governments’ provision of competitive services, which was memorialized in the Commission’s General Order dated October 4, 2005 (R-28270).

III. SUMMARY OF AUDIT AND STAFF’S RECOMMENDATION

Staff filed its *Audit Memorandum* on June 4, 2019, and the audit was published in the Commission’s Official Bulletin on June 14, 2019 for a 25 day intervention period. On June 17, 2019, LUS filed its *Notice of Intervention and Inclusion on Service List*.

In addition to testing LUS’ compliance with the Commission’s rules, the audit reviewed the financial results reported by LUS’ Communications System during the period of fiscal year 2008 through fiscal year 2017. After eight years of reporting losses, the Communications System has reported net income for fiscal years 2016 and 2017. Furthermore, beginning in fiscal year 2013, the Communications System has not entered into additional interfund loans with LUS in order to satisfy its imputed tax obligations. The Communications System revenues have been sufficient to pay the imputed taxes outright rather than set up a note payable due to LUS. The profitability of the Communications System has been increased by an update of depreciation lives as well as affiliate billings to LCG departments and LUS divisions.

Staff also reviewed the debt service obligations of the Communications System. The outstanding balance of Revenue Bonds is approximately \$101.2 million and there was an

additional balance of approximately \$27.2 million due from LUS for interfund loans. The bulk of the debt service requirements are still ten to fifteen years away, but the Communications System must continue to grow its customer base and revenues in order to satisfy these obligations. Staff noted that the Communications System has satisfied all loan covenants for both the interfund loans and the Revenue Bonds each fiscal year.

As part of the review of the affiliate transactions that the Communications System has engaged in, a series of billings for services rendered to LUS by the Communications System was examined in order to determine whether LUS complied with the Commission's Code of Conduct rules.³ The series of affiliate transactions subject to further investigation stems from the billings over a period of years by the Communications System to the Wastewater and Electric Divisions of LUS for services that were not being used by those divisions. The issue is whether the Communications System inappropriately benefitted from these dealings with its affiliates. In response to the uncertainty surrounding these affiliate transactions, LUS Fiber transferred the money paid to the Communications System for the unused services back to the LUS Utilities Fund. The transfer amount, including interest, totaled \$1,752,194.85 for the unused services. LCG's independent financial statement auditor concluded that "[S]ince the Lafayette Utilities System was not able to utilize these services, the payments made to the Communications System did not reflect the fair value of services utilized. The difference in the exchange transaction could be considered an unintentional appropriation to the Communications System."

Staff also found that the payments made by the Wastewater and Electric Divisions of LUS for the unused services provided by the Communications System represent acts of noncompliance with the LPSC's Code of Conduct with respect to affiliate transactions. The Commission's Code of Conduct provisions are quite clear: a local government may not discriminate between the separate division created to provide the covered services and any other entity in the provision or procurement of goods, services, and information from its affiliated divisions, or in the establishment of standards. In the case of the unused services provided by the Communications System to the Wastewater and Electric Divisions of LUS, there was the appearance of self-dealing that clearly benefitted the Fiber Utility. In effect,

³ General Order, Attachment A ("Cost Allocation and Affiliate Transaction Rules), p. 17.

the Wastewater and Electric Divisions of LUS procured services from the Communications System that were not needed, and therefore, were a form of subsidy to the Fiber Utility. LUS is taking measures to strengthen its internal controls going forward in order to mitigate the possibility that such transactions go undetected in the future. However, based upon Staff's review of the matter, Staff recommended that the funds transferred from the Communications System, representing the billings of unused services plus interest in the amount of \$1,752,194.85, be retained in the LUS Utilities Fund.

With the exception of the affiliate transactions for the unused services billed by the Communications System to LCG and LUS, Staff finds that LUS has complied with the LPSC's rules. The compliance extends to the direct assignment and full allocation of costs to the Communications System, balance sheet accounting that is in accordance with generally accepted accounting principles ("GAAP") as established by the Governmental Accounting Standards Board, the appropriate allocation of revenues and expenses, the requirements regarding interfund loans and the assignment of costs associated with the Communications System Revenue Bonds, the imputation of taxes, fees, and other assessments as would be incurred by a similarly situated private provider of covered services, reasonable time reporting procedures, and fulfilling the reporting requirements of the Commission.

At the Commission's December 16, 2020 Business and Executive Session, the Commission directed LUS to file a response to Staff's Audit Memorandum, as no response had been filed. On January 25, 2021, Executive Secretary Brandon Frey sent correspondence to counsel for LUS, again requesting a response to Staff's *Audit Report*. On February 8, 2021, LUS filed its *Acceptance of Staff Audit Memorandum and Comments* ("Acceptance"). In the conclusion section of its Acceptance, LUS states that "LUS concurs with the LPSC Staff's conclusion that the Communications System complied with the LPSC Rules except for the affiliate transactions regarding unused services; and LUS accepts and does not contest the Staff Audit Memorandum and the recommendations therein." As such, Staff filed its *Staff Report and Recommendation* on March 2, 2021, and made no changes to its findings and recommendations as filed in its *Audit Memorandum* filed on June 4, 2019.

IV. CONCLUSION

This matter was considered by the Commission at its March 17, 2021 Business and Executive Session. On motion of Vice Chairman Skrmetta, seconded by Commissioner Francis, and unanimously adopted, the Commission voted to assert its original and primary jurisdiction and take the matter up pursuant to Rule 57. On motion of Vice Chairman Skrmetta, seconded by Commissioner Francis, and unanimously adopted, the Commission voted to accept Staff's Report and Recommendation filed into the record on March 2, 2021.

BY ORDER OF THE COMMISSION
BATON ROUGE, LOUISIANA
March 19, 2021



DISTRICT II
CHAIRMAN CRAIG GREENE

DISTRICT I
VICE CHAIRMAN ERIC F. SKRMETTA

DISTRICT V
COMMISSIONER FOSTER L. CAMPBELL

DISTRICT III
COMMISSIONER LAMBERT C. BOISSIERE, III

DISTRICT IV
COMMISSIONER MIKE FRANCIS

A handwritten signature in blue ink, appearing to read "Brandon M. Frey".

BRANDON M. FREY
SECRETARY