Dark Fiber Transactions Involving Local Governments: Overview and Key Issues

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What is “Dark Fiber”?

- One or more unused or unactivated fiber optic strands, within a fiber optic cable.
- Installation and operation of activating electronics can be done by the owner, or by another party.
- The right to use the strand to transmit information is legally distinguishable from the ownership interest in the underlying fiber optic facility.

Dark Fiber Transactions: Examples

- Fiber owned by city or municipally owned utility, used historically for municipal / utility purposes:
  - Right to use fiber granted to another entity for development / expansion of a retail communications network. (P3?)
- Fiber owned by county, need to connect to a hospital outside of fiber footprint.
  - Negotiates deal with owner of fiber between county network and hospital. May involve fiber swap, expanding reach of both networks
- Fiber owned by telco or cable company in local PROW.
  - Locality obtains right to use fiber (cable I-Net, in-kind compensation etc.).

Dark Fiber Transactions

A right to use dark fiber is normally granted as either an **"indefeasible right of use"** (IRU), or a dark fiber lease.

"Indefeasible Right of Use" (IRU)

- The most common method by which rights in fiber optic cable are transferred within the telecommunications industry.
- An IRU is an agreement granting the exclusive use of dark fiber (a "dark fiber IRU") or capacity (a "capacity" or "lit fiber IRU")
- Term normally corresponds to the useful life of the asset
  - Fiber = 20 years, +/-
- Payments for right to use are front-loaded
  - Maintenance fees can be periodic
- As close to an outright sale as possible, without transferring title.
- IRU purchaser normally allowed to treat its investment as a capital cost, rather than an operating expense.

"Indefeasible Right of Use" (IRU) vs. Dark Fiber Lease

- Terminology often used interchangeably, and in fact very similar.
- Both involve an exclusive, irrevocable (so long as IRU fee and lease payment are made) possessory interest in certain property, for a term. Both may (but need not) be transferable. Title to the property remains with grantor/lessor.
- But a lease may be preferable when:
  - Use payments are spread over the term, rather than mostly upfront.
  - Term of agreement is significantly shorter than the useful life of the asset.
  - Grantee is unconcerned with treatment as capital vs. operating expense, for tax purposes.

Typical Contents of Dark Fiber IRU or Lease

- Specific description of the dark fiber: route map, locations served, number of strands, etc.
- Premises entries
- Demarcation points
- Access to facilities by grantee (splicing, equipment activation, testing, etc.)
- Maintenance / relocation terms: address respective rights and obligations relating to:
  - Periodic / routine maintenance
  - Emergency maintenance in the case of physical damage
  - Expenses in case the fiber must be relocated
  - Pro-rata allocation among other uses in the cable may be appropriate.

Typical Contents of Dark Fiber IRU or Lease

- Use conditions and encumbrances: Grantor may require grantee to use dark fiber only for particular purposes or may prohibit certain uses.
  - Example: telco that leases dark fiber may prohibit lessee from using the fiber to offer a service that competes with the lessor.
  - Example: Grantor may require grantee to use the fiber consistent with certain nondiscrimination and interconnection terms and conditions (federal BTOP program)
  - Example: Grantee may require grantor to permit grantee's affiliates to use fiber, or to acquire IRUs of their own.

- Disposition upon termination: Does the grantee have an option to purchase the asset at the end of the term? Renewal terms?

Issues Involving Dark Fiber Transactions and Local Governments

- Authority issues:
  - Does the locality possess the underlying authority to undertake the transaction?
- State barriers to municipal provision of telecommunications
  - Are you in one of the 19 states with some form of prohibition against municipal communication services? Check to see whether it may affect dark fiber (i.e., facility "used to provide …"?)
- Be mindful of the "agent" argument.
  - Depending on the relationship between the locality and the grantee, the grantee's actions could arguably be imputed to the locality.

Issues Involving Dark Fiber Transactions and Local Governments

- Regulations concerning lease of government property
  - Strict local rules concerning lease of government-owned property may not be well suited to realities of dynamic telecommunications industry.
- Private use exception to tax-favored financing
  - Some forms of municipal financing impose limits on the extent to which a financed asset may benefit a particular private party.
  - Example: Excess dark fiber funded by tax-favored municipal bonds IRU'd to for-profit telco without restriction.
- BTOP encumbrances and conditions
  - Nondiscrimination and neutral interconnection obligations under BTOP generally "flow through" to subsequent users of BTOP-funded facilities.

Q&A

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