THE WIOCC EXPERIMENT

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Abstract: In 2004, when EASSy feasibility study was launched, submarine optic cables were simply ignoring the East African coast!
The majority of East African carriers signed an M.O.U. to build the EASSy project under a consortium model. However, numbers did not add up to get this 10,000 kilometer project fully financed. In parallel, Development Finance Institutions found the project emblematic and offered to fully fund EASSy… on certain conditions. The two models were clashing and a new path had to be found for EASSy to become a reality.
Axiom was engaged to set-up a hybrid "consortium - private" model, based on an ad-hoc structure being a Party to the EASSy C&MA.

1. EASSY GENESIS

The concept of EASSy, a submarine optical system along the East coast of Africa was born in 2003.
At that time, this sub-continental region, cradle of mankind, rich of several hundreds of millions souls, remained isolated from the modern optical worldwide network. It made sense to remedy it!
A modern telecommunication infrastructure, including connection to the global fiber network, is now considered as one of the key prerequisite to any country's economic development. The EASSy project thus quickly became of interest to the World Bank and other Development Funds Institutions ("DFI").
While the system was starting to be promoted towards regional and worldwide telecommunication carriers, the World Bank commissioned Axiom to perform a detailed feasibility study in 2004. This study confirmed feasibility of such a system and its interest for the region development.
With growing appetite for the project from both carriers and DFIs, tension started to arise between supporters of the "Consortium Model" and supporters of a "Private Model".

2. PRIVATE VS CONSORTIUM

There are fundamental differences between a project managed under the Private Model, i.e. owned by a private structure even if sponsored by « public funding » and a Project built by a Consortium, i.e. co-owned by a group of international carriers.

2.1 Consortium Model

In a Consortium, all co-owners get capacity in return to their investment. The sum of investment shall amount to the total project financing and no external financing debt or equity) is possible. In such scheme, each Party's return on investment is mostly the result of the use of the capacity or, in other words, the savings compared with buying or leasing such international capacity and only marginally capacity sales to other carriers.
Each carrier-member will leverage its position within the consortium as a competitive advantage against competitors that did not chose or get the opportunity to participate. Consortium members will endeavor limiting competitors' access to the System capacity at technical and commercial conditions close to theirs.

Because consortium cables require to be fully financed initially, carriers have to invest for short and long term needs.

2.2 Private Model

In a Private Model, the System is owned by a private entity, usually set-up for the purpose of receiving equity and debt for the financing of the construction and sometimes of the early operation of the System.
The return on investment for equity investors and repayment of the debt shall therefore be in cash.
The cable entity will therefore sale or lease capacity and the subsequent revenues will be used to serve the debt and provide dividends to equity.
On the carrier side, such system allows to purchase capacity as needed. Purchases are based on short term needs and the initial sales revenues only represent a portion of the System cost. The financing entities "bet" on the long term needs to recover capital and interests.
Subsequently, it appears that in such Model, the broader market base, the better.
Because, the Consortium Model did not allow direct financing of the project, the DFIs proposal was based on a Private Model.

3. PUBLIC FUNDS

The DFIs' solution of a Private Model was not only driven by an interest for return on capital, it was also driven by the DFIs requirement for an EASSy System built and operated in a way that would sustain the economic development of the region. The DFIs goal was to make the EASSy capacity a "cheap, fair and accessible international capacity to all".
The SAFE/SAT3 experience, where DFIs supported individual carriers off the West coast of Africa had left a bitter souvenir. Such local support helped the project to happen, but was not able to fight against local monopolies, maybe even encouraged them. This had been largely emphasized and criticized in the media in each concerned country. If SAFE/SAT3 had finally been a major asset in developing Africa's west coast economy, this time DFIs wanted to do even better!
Needless to say that supporters of the Consortium Model were reluctant of the initiative from the World Bank and other DFIs aiming at offering good conditions to the whole market, including their market and thus their direct competitors.
One can easily imagine other negative aspects of "public money", among which, very tight control, tons of prerequisites and over-administrative supervision of the project.

4. TOWARDS A NEW MODEL

4.1 Navigating between Scylla and Charybdis

In the 2005-2006 timeframe, proposals to fund the project under the two models were co-existing.
On the one hand, carriers signed a Memorandum of Understanding ("MOU") and were regularly meeting within the forums of an Interim Management Committee ("IMC") and all standard sub-committees and sub-groups. The aim was to draft a Construction and Maintenance Agreement (C&MA") and also to negotiate a supply contract. Despite the obvious shortfall in financing, the consortium inertia resulted in the signature (but not the entry in Force of course) of a C&MA in October 2006 and of a supply contract in March 2007.
On the other hand, the World Bank, its private sector arm; the IFC and other DFI (EIB, KfW, AFD, DBSA and ADB) were keeping on promoting a fully funded project conditional to "Open Access" principle.

Each side was trying to convince the other, with no success, or more probably expecting to win by K.O.

However, by the end of 2006, it became clear that neither of the two proposals would fly: on the one hand, the consortium investment rules and subsequent capacity price were such that five of the potential landing were not able to meet the minimum landing party investment tickets, while the unit price of capacity was so (relatively) low that big players were not investing enough. The financial gap was significant and no concrete solution to bridge it was in sight, as all efforts to attract other carriers had proved vain. Even worse, the delays and lack of progress of the consortium, allowed competitive alternatives to develop. Some of EASSy Initial Parties, doubting on the chance of closure of EASSy, started hearing the mermaids' songs loud and clear, with a clear risk of defection and subsequent increase of the financial shortfall.

The system configuration was not stable, with some landing parties likely to disappear, not being able to fund the minimum ticket.

On the other hand, the model proposed by the DFI could not get the support from some of the major carriers/investors. One of the many reasons for such resistance was linked to a higher cost of money when borrowing from the DFI than accessible to tier one carriers and more fundamentally the lack of control in the long term capacity prices.

The project was entering in a vicious circle where its loss of momentum and lack of real progress (the announcement of the great achievement consisting in the signature of the C&MA did not foul many players…) would soon mean its end.

It became urgent to find another path and put the project back on rails…running "forward". This would only come by working together and not against each other.

4.2 Soon cruising in more gentle waters

All the variables of the equations were known and could be summarized as follows;

- Some (key) carriers wanted to invest directly and own their share of the system,
- Some carriers, though key in EASSy configuration, were not in a position to finance the minimum landing party ticket,
- The overall carrier investment power in the region (and beyond) was not enough to finance the project,
- DFIs were prepared to finance all or part of the project, provided that reimbursement was reasonably insured through selling of capacity,
- DFI financing would be conditional to EASSy being an "Open Access System", i.e. its capacity being made available to all carriers in the region at attractive conditions in a fair and equitable manner to all.

The solution was found and consisted in creating a Special Purpose Vehicle ("SPV") carrying the DFIs financing and small carriers investments. Such SPV would be one of the Initial Parties of the EASSy consortium, co-investing in the project in parallel with other intial Parties, consisting of carriers directly investing in the project.

The carriers selecting to enter the SPV would become its shareholders and customers.

The SPV would not only cover the "tickets" of its landing parties/shareholders but would bring sufficient funding to close the overall financing of the project. In return, the C&MA would be "liberalized" to accommodate for the SPV to be able to sell capacity over the entire region and thus access a wider market to minimize the risk of the debt providers, aka the DFIs.

The SPV "constitution" would include an obligation to sell capacity at low price in a fair and equitable manner to all carriers, including those not shareholders of the SPV. This would thus satisfy the DFIs requirement in giving access to all carriers in the whole region to reasonably and fairly priced international capacity.

The above principles were set and agreed upon early 2007…. But, as always, Devil is in the details.

5. WHO SAID IT WAS EAS(S)Y ?

5.1 From principle to reality

Now the project had a clear steering. Axiom role became to set-up the SPV, design short and long term participation rules in the SPV, negotiate with the "Consortium", the DFIs, the Supplier and the potential shareholders to put the solution in place. Of course, each entity had its own agenda, which differed, should I say diverged, from each other.

Setting up the SPV was easy. DFIs and potential shareholders agreed that Mauritius and its tax-friendly policy was a very good place for a company selling products mostly located in international waters. The SPV became the West Indian Ocean Cable Company, aka WIOCC.

However, the equation described above that could be rather simply solved in principle became a set of complex equations interacting with each other, which key points were:

- Consortium direct members agenda:
  - Maximize SPV investment in EASSy to fill the shortfall in the project financing and thus reduce the need for direct Parties to make an additional financial effort,
  - Limit the SPV ability to sell capacity at good price to their competitors,
- DFI agenda:
  - Open the East African telecom market by giving fair access international at reasonable price,
  - As any commercial bank, maximize chances of repayment of the loans (capital and interests), i.e. use the most pessimistic business plan and insure maximum pre-sales and onward commitments, implement contingencies at all levels and oversize any expected charges…
  - Complete the deal within its own administrative rules (which differ from one DFI to the other and proved to be very heavy sometimes),
  - Revise the Supply contract and C&MA to suit the needs of the WIOCC and the loan providers.
- WIOCC potential shareholders:
  - Maintain their position as landing party and subsequent rights,
  - Reduce as much as possible their financial commitments, especially short term (equity and capacity pre-sales),
  - Insure access to capacity at reasonable price from the WIOCC in the short and long term.
  - Reduce as much as possible the cost of money lent by the DFIs.
- Supplier:
  - Maintain (or improve) contract conditions,
  - Make sure all Purchasers' liabilities are adequately guaranteed, including that significant share financed by WIOCC.
  - Limit any delays in the Coming into Force of the Contract.

At this stage of the project we therefore considered purchasing an aspirin factory to save on everyone's medical expenses.

5.2 Make it bankable

The first action was to set-up some rules of equity investment, pre-sales and long-term capacity commitments (off-take contracts) which would insure sufficient level of equity, i.e. an equity/debt ratio acceptable to lenders, attractive pre-sales price compared with low level direct investment for SPV carriers, sufficient committed revenues in pre-sales and off-take contract to secure a major part of the debt financing. Eleven carriers decided to invest as shareholders of the WIOCC, among which, one was also a direct investor in the C&MA and five were landing parties (out of eight landing points).

The second action was to draft "a bankable story" in the form of an information memorandum and an audited business model. This document would be used by each DFI to obtain the Holy Grail: the "Board Approval" to officially make a loan proposal to WIOCC in the form of a Term Sheet.

These two actions were completed first half of 2007 and early July 2007, we received the Term Sheet.

5.3 Learning what is a "Condition Precedent"

Was it the end of the tunnel? In view of the number and type of conditions precedent included in the Term Sheet, the interest of purchasing an aspirin factory became even more obvious.

The following months consisted in fulfilling conditions to the signing, the effectiveness and the first draw of the loans. Conditions precedent came in various colours and forms. The five DFIs had common ones and also specific ones.

During the same time, the loan documentation was being negotiated and drafted by the WIOCC lawyer – one of the most efficient and business oriented lawyer I ever met – and the DFIs lawyer firm (thankfully they had accepted to share one rather than each having its own). This resulted in 31 formal documents, some of them nearly 200 pages.

The quest for a no-risk deal continued and the business model became more and more conservative.

Loans were signed in November 2007, the revised supply contract in February 2008.

5.4 Maneuvering in rough seas

As if the above process was too simple, Murphy's law decided to introduce additional perturbations from the outside world, such as:

- Some of the Initial Parties defecting, creating a new gap in the overall project financing,
- Political pressure from South African government, resulting in uncertainty to obtain landing permits in Mtunzini and one of the DFI, stepping out,
- US dollar collapse versus Euro and fuel price peak resulting in the European supplier requiring a significant contract price increase obviously leading to further enlargement of the financing gap.

Some of the above issues resulted in further delays but solutions were found to all problems and the implementation started in the second quarter of 2008.

6. AND THEN BUSINESS AS USUAL…

Axiom remained WIOCC interim management team for a few months, enough time to hire a permanent team, which has proved very successful. Axiom however remained part of the procurement group during the construction of the System.

Despite two third of its length being located in war zone off Somalia, the System was built on time, within budget and with performances exceeding by far the specifications. The remaining contingencies allowed upgrading the system to more than 6 times its initial lit-up capacity without calling for additional investment. The one fly in the ointment was the impossibility to implement the Somalia landing due to obvious security issues…Hopefully, this will be solved soon.

From recent discussions with WIOCC management, the business plan, in its DFI accepted version, indeed proved to be over-pessimistically conservative. WIOCC seems to have been performing far better than on paper.

7. CONCLUSIONS AND ACKNOWLEDGMENTS

The East Africa Coast is now part of the global village and the goal of opening the access to international connectivity has been achieved.
Looking back, it seems that the solution that was put in place was the best or even the only solution that could allow the EASSy project to fly and to achieve DFIs aims.

EASSy would not have existed without the strong will of a few, who, beyond the guidelines of their companies (carriers, DFIs, suppliers, etc.), were able to see farther and make all points of view converge to achieve the project. In a way, EASSy was (and remains) one of the best human experience I have had.

I therefore take the opportunity to extend my thanks to all that contributed to EASSy and WIOCC success. It’s been great working with you.