



# SubOptic -2007

*Enabling Global Communications*

# Legal Aspects of Bandwidth Sales

for New and Existing Systems



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# Topics to cover

- The true legal meaning of an “IRU”
  - Protecting against insolvency
- The contents of a submarine capacity contract.
  - Ensuring Continuous Quality – contractual mechanisms.
  - Terminating a submarine capacity contract.

# The meaning of an IRU

## History of Submarine Cables

- Pre 1995 – international consortia of incumbents
  - Only the incumbent could “run a system” in the territory
  - No competition – so no customers for private cables
  - Demand growing relatively slowly (pre internet)
- Operators joining the consortium bought an “indefeasible right of use”, or **IRU**
- Paid-for up-front.

# The meaning of an IRU

## History of Submarine Cables

- Owners of an **IRU** had:
  - right to a *proportion* of the capacity, not a fixed amount
  - obligation to pay *proportion* of maintenance costs
  - right to participate in decisions
- If other members of the consortium became insolvent – minimal impact – their rights to the cable continued

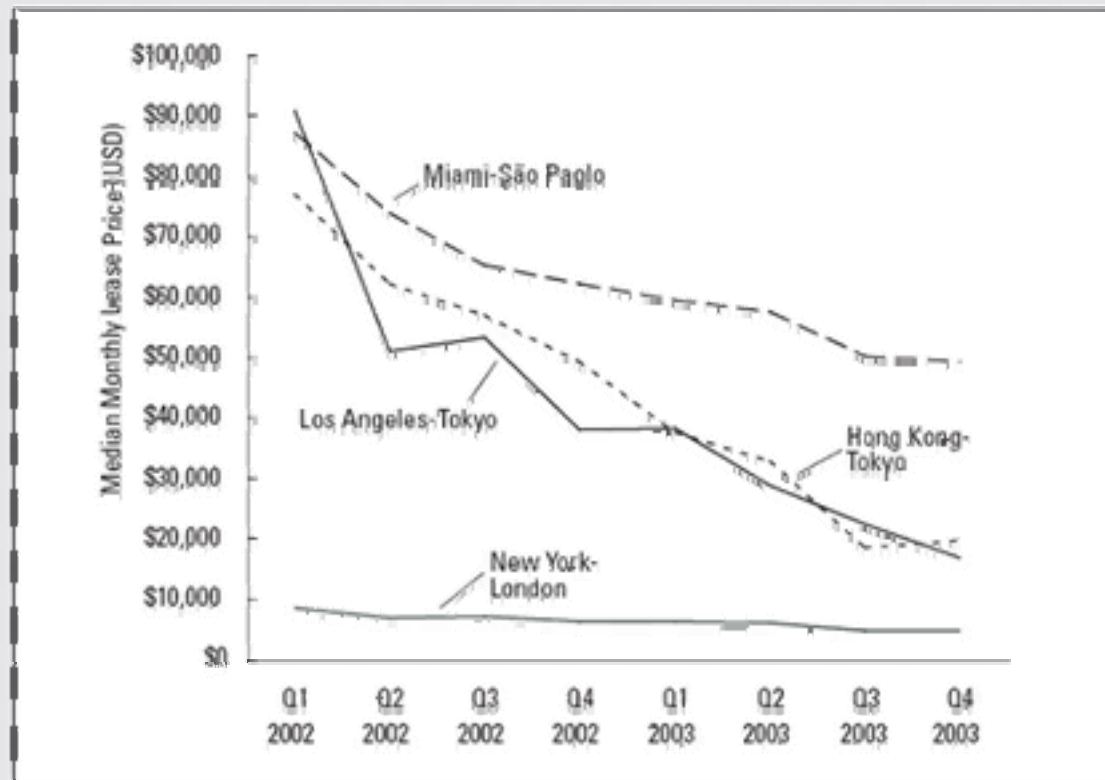
# The meaning of an IRU

## History of Submarine Cables

- But, after 1995ish:
  - Development of the internet increases demand
  - New technologies increase supply
  - Liberalisation of markets creates the opportunity...
- And the result was a **huge** expansion.

# The meaning of an IRU

Figure 2. STM-1 Price Trends, 2002-2003



Notes: Prices reflect median STM-1 monthly lease prices, exclusive of installation fees.

Source: TeleGeography research

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# The meaning of an IRU

## Private Cables

- After liberalisation, new companies were permitted to provide services
- Development of project finance – banks would lend to start-ups, taking security over the assets to be built.
- For the first time, private operators could build cables as a business in itself
- Because of the industry history, *called* an “IRU” but bore little resemblance to traditional meaning.

# The meaning of an IRU

## IRUs – consortia and private

Consortia IRUs	Private IRUs
Proportion of total capacity	Fixed Capacity
Proportion of maintenance costs	Fixed costs
Take-what-you-get on service levels	Guaranteed service levels
Right to participate in decisions	No right to participate
Insolvency of other members has minimal impact	Unsecured creditor in the event of insolvency

# The meaning of an IRU

## But then...

- When the boom ended, holders of “IRUs” were left negotiating from a position of weakness. Though not so bad:
  - Most insolvency proceedings do not allow contracts to be set aside without court permission
  - Even where set-aside is permissible, O&M payments often represent a reason to honour the contract

# Protecting against insolvency

## Taking Security over an IRU

- Limited assistance because:
  - Second place to the banks' security
  - Not *possible* to take security except over specifically identified assets – ie specific fibres
  - And even then, no use without rights of way, rights to use transmission and multiplexing equipment
  - So, especially for *submarine* fibres, where more equipment cannot easily be added, security is not much use.

# The meaning of an IRU

- There is **no magic** to an “IRU”.
  - An “IRU” is just a bundle of contractual rights
  - You only get what the contract says you get
  - In most cases it is a simple service agreement
- So, why pay up-front?
  - Trend towards paying periodically (eg annually)
  - FASB rules changed –IRUs are considered as “operating leases” (services contracts) – revenue recognised over the lives of the agreements rather than as asset sales.

# The contents of a capacity contract

- Definition of what's been purchased
  - Capacity – wavelength, STM-1, whatever
  - Route
  - Restoration service
- Payment terms
  - One-off or periodic? Phased with network activation?
  - Goes to the IRU / service contract point
- Price protection
  - IF better prices are offered to others
    - either refund; or
    - extra capacity
  - Value questionable (confidentiality means no information)
  - Watch out for competition / anti-trust law problems

# The contents of a capacity contract

- Benchmarking? Or “Market Testing”?
  - Common in many service / outsourcing contracts
  - Does it make sense in a subfibre context? Probably not – unless
    - Payments are periodic; and
    - there’s competition on the route – so comparisons can be made
- Upgrade rights / options
  - Right to participate in upgrades?
  - How to determine how much extra capacity is bought, and for how much?
- Restoration available?
  - Details
  - NB - How does this affect the service levels?



# The contents of a capacity contract

- Service Levels and Service Credits
  - Actually fairly simple because there's just one service
  - Should address the crucial (***measurable***) elements, and the required standards
  - Eg: time to fix (per break, in days or hours); error rates; jitter levels
  - Availability (99.99%?) or “outage time”, in days, per month?
  - NOC - Status information / reports to be provided
- Service Credits allow customer redress for poor service without the need to pursue legal action.
  - How much?
  - When payable?
  - On what basis?

# The contents of a capacity contract

- Often network operators expect service credits to be the “sole and exclusive” remedy
  - But service credits do not usually offer true compensation for poor service (rather they remove some of the operator’s revenue).
  - If service is very poor, the customer must be able to seek additional damages or to terminate the agreement.
  - In any event, service levels can’t cover every potential problem - network problems only
- Co-location details – at cable station or POP
  - Rack space
  - Facilities (eg power, fire suppressant systems)
  - Other services (eg emergency access)
  - Provided by a third party?

# The contents of a capacity contract

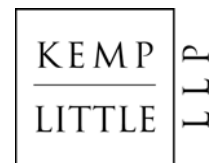
- Warranties re: quality – ITU recommendations
- Planned maintenance
  - Details – how often, notice periods etc
- Price
  - Fixed? Index-linked?
  - Percentage of actual o&m costs?
- Conditions Precedent (if a pre-sale)
  - Esp re: financing of the project
- Assignment
  - Can the capacity be broken up and re-sold? (again, competition law concerns if not)

# The contents of a capacity contract

- Liability limits
  - Usually on long term service contracts liability is a percentage of the annual fees
  - In subfibre context, if there's a one-off "IRU" fee –this doesn't work
  - Instead – percentage of the IRU fee?
  - "Indirect or consequential loss" exclusions – confusing.
    - better to come up with a list of things the operator *is* liable for
      - eg cost of short term lease of alternative capacity

# The contents of a capacity contract

- Term and termination
  - Fixed term - usually
  - Extendable?
  - Termination early “for convenience” (ie no fault termination)?
  - Termination “for cause” –
    - Material breach (on customer side, really just non-payment)
    - Should try to define what a “material” breach is on the operator’s side
    - Insolvency – but, the contract could be a key asset of the insolvent customer – so customers argue against
    - Change of control? Loss of telecoms licence / authorisation?
  - Especially if payments are periodic - customers should avoid accidentally “affirming” a breach by the operator – prejudicing customer’s ability to terminate “for cause” later.



# The contents of a capacity contract

- Force majeure
  - NB shouldn't apply to mere cable breaks!
- Governing law and dispute resolution
  - English law is common, as is New York, California
  - Disputes – courts of the jurisdiction or arbitration
  - Arbitration (eg by ICC) – can be expensive, inconvenient
- Intellectual Property Rights
  - Nothing transfers



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