

Key Commercial Contracts in the Submarine Cable Business

MasterClass Tutorial 1

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Presenter Profile

Mike Conradi

Mike is a partner at specialist technology law firm Kemp Little LLP. The legal guide *Chambers and Partners* says of him that “[he] produces punchy and straightforward answers - he’s direct and commercial, and gets to the point quickly.”

He has a particular focus on submarine cables and was the only private practice lawyer on the SubOptic Interim Activities Working Group which has produced a model system construction contract.

Mike is the editor of the *Communications Law Handbook*. He is listed as one of the world's leading telecoms lawyers at www.expertguides.com.

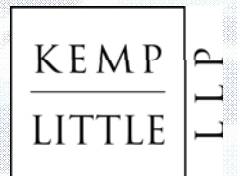


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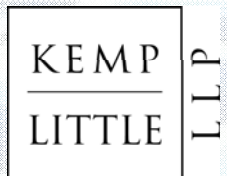


Topics to cover

- Capacity contracts – IRUs and leases
 - The System Construction Agreement
 - (IAWG session tomorrow for more on this)
 - The C&MA
 - Maintenance Agreements
 - Landing Party Agreement
 - Cable Crossing Agreements
- NOT – finance contracts

Capacity Contracts – What’s an “IRU”?

- The *true meaning of an IRU (!)*
- Pre 1995 – international consortia of incumbents
 - Only incumbents could “run a system” in their territories
 - Operators acquiring capacity bought an “indefeasible right of use”, or **IRU** from the original parties to the C&MA
 - Paid-for up-front.
- Owners of an **IRU** had:
 - (usually) right to a *proportion* of the capacity, not a fixed amount
 - obligation to pay *proportion* of maintenance costs
 - (often) right to participate in decisions
 - capacity available for the full life of the system
 - little need to worry if one of the “Grantors” became insolvent



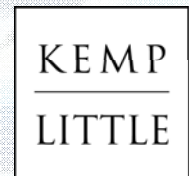
Capacity Contracts – What’s an “IRU”?

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 a cable as a business in itself, and sell capacity to operators
- Because of the industry history, *called* an “IRU” but bore little resemblance to traditional meaning.

Capacity Contracts – What’s an “IRU”?

Consortia IRUs	Private IRUs
Proportion of total capacity	Fixed Capacity
Proportion of actual maintenance (or other) 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
Life of the system	Fixed (or minimum) term



Capacity Contracts – What’s 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 – and in most cases it is a simple service agreement
- Rev Rec?
 - 1999: FASB rules changed – IRUs are considered as “operating leases” (services contracts) – revenue recognised over the lives of the agreements rather than as asset sales.
 - Can an IRU be a real asset sale? Key Questions:
 - Does the IRU give rights to specific identified assets; **and**
 - Does title in those assets transfer?
 - Answer to both must be “yes”. Does Unity work this way?

Capacity Contracts

- Definition of what's been purchased
 - Capacity – wavelength, STM-1, whatever
 - Route & Restoration service
- Payment terms
 - One-off or periodic? Phased with network activation?
- 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?
 - 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?
 - Determination of how much capacity is bought, and price?
- Service Levels (availability and planned maintenance)
- Co-Location
 - Rack Space / Facilities etc

The contents of a capacity contract

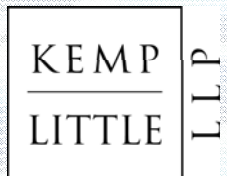
- Price
 - Fixed / Index-linked? Percentage of actual o&m costs?
- Conditions Precedent (if a pre-sale)
 - Esp re: financing of the project
- Assignment
 - Can the capacity be broken up and re-sold? (again, competition law concerns if not)
- Liability Limits
 - Percentage of the IRU fee?
 - Indirect & Consequential – confusing.
 - So specify, eg, cost of short term lease of an alternative.

The contents of a capacity contract

- Term and termination
 - Fixed term – or life of the system?
 - Termination “for cause” –
 - Material breach (on customer side, really just non-payment)
 - 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?
- Governing Law / Dispute Resolution
 - Often a good reason to choose **arbitration**

The System Construction Agreement

- SubOptic Interim Activities Working Group has produced a draft, including notes
- Session tomorrow to explain / discuss
- Deals with issues such us:
 - Billing & Liability as between consortia members
 - Permits
 - Design Life / Upgradeability
 - Supplier's Performance Bond
 - Surveying the route (and risk of changes)
 - Either risk changes, or separate the survey into an initial contract?
 - Acceptance stages
 - Completion Deadline



The Construction & Maintenance Agreement

- Governs the relationship as between consortium members
- Each party commits to pay a portion of capital costs and gets an ownership portion.
 - The two portions are **not** necessarily the same – some C&MAs offer greater capacity for a larger financial commitment
- Divide the cable into “segments” – “S” & “T” (landing stations)
 - Usually the “T” segments are (owned and) run by the landing party, whose costs are compensated by the other parties
 - If the cable has multiple landing stations, could allow parties to switch their capacity between landing stations
 - Do this by allocating a number of MIUs (STM1-km) to each party
 - Formula needed to allocate the capital costs of the landing stations – can be very complex.



The Construction & Maintenance Agreement

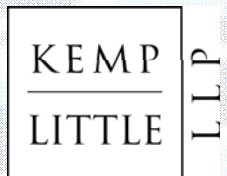
- Governance structure is very important:
 - Management Committee
 - How meetings are called
 - Decisions – if no consensus then by voting in proportion to ownership share
 - Specifying what the MC can and cannot decide (eg close a landing station?)
 - Sub-committees – typically technical & financial, could also include operational and procurement
- Deals also with execution of the “Supply Contract” – ie to supply & install the “S” segment
 - Including liability under the Supply contract (joint and several?)
- Central Billing?

The Construction & Maintenance Agreement

- Capacity / congestion reserve
 - allocation and use (eg for restoration)
 - consequences of the MC deciding to increase / decrease the reserve
- Expansions and Upgrades
 - How decisions are made, who pays and who benefits
- O&M costs
 - Could be divided according to capacity *activated* rather than *allocated*
- Decisions to decommission or to extend the life of the system
 - sharing of decommissions costs (to include former parties)
- Assignment of a party's entire interest (usually) prohibited
 - But a "transfer of use" – where the original party remains a party to the C&MA but sells capacity to another – is permitted.

Maintenance Arrangements

- Standby cable repair fleet is prohibitively expensive
- **Zone-Based Maintenance Arrangements**
 - Group of owners in a geographic zone agree a maintenance service with (one or more) cables ship owners
 - Division of standing-charges in proportion to cable length
 - When a fault occurs, incremental costs are paid by the owner of the cable that has broken
- Works itself like a consortium agreement – with governance, cost-allocation etc.
- KPIs on cables ship owners, but their liability (to all owners) is capped
- One downside – once you're in you (usually) can't leave without decommissioning the cable
- Examples: NSCMA, ACMA, SEAIOCMMA, PIOCMA
- **Emergency call-out** – risk on availability and cost



Other Agreements

▪ Landing Party Agreements

- Separate agreement with the landing party usually applies only to private and not consortium cables
- The LP agrees to provide a landing station (or part of one), interconnection facilities
- Backhaul service to be offered to the system's customers on fair, reasonable and non-discriminatory basis
- Other operators to be permitted to access the station themselves so as to offer backhaul to the customers.
- Permitting
- Service Levels, service credits

Other Agreements

▪ Cable Crossing Agreements

- Outside of territorial water (12 miles) such an agreement may not actually be needed but it's prudent
- ICPC recommended agreement
- Sets out:
 - technical details about how the crossing will happen
 - Liability – caps and exclusions
 - NB: ICPC recommends that consequential loss be excluded. Very often pipeline owners do *not* adhere to this.
 - Ongoing maintenance of either – notification, procedure etc
 - Term and termination

Questions

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