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Daoust Vukovich Baker-Sigal Banka LLP
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"TELECOMMUNICATION LICENSE AGREEMENTS IN MULTI-UNIT COMMERCIAL BUILDINGS"

Prepared By: J.E. Dennis Daoust
Law Society of Upper Canada
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20 Queen Street West, 6th Floor, Toronto, Ontario M5H 3R3
Tel.: 416-597-6888 Fax: 416-597-8897 E-mail: general@dvbb.com Web: www.dvbb.com

TELECOMMUNICATIONS LICENSE AGREEMENTS
IN MULTI UNIT COMMERCIAL BUILDINGS

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J. E. D. DAOUST,
DAOUST VUKOVICH BAKER-SIGAL BANKA

Background

There was very little competition in the telephone business in Canada until 1992 when long distance competition was introduced. That set in motion a review process that culminated in the series of decisions announced by the Canadian Radio-television, and Telecommunication Commission (the "CRTC") in May of 1997, the purpose of which was to introduce competition into the local telephone exchange market. The intent was also to facilitate the convergence of the telecommunications and broadcasting distribution (i.e. cable company) industries.[1]

These developments have resulted in new entrants into the industry and are affecting many aspects of business. Particularly important, for our purposes, is the way they affect owners and managers of multi tenant buildings (for simplicity, referred to in this paper merely as "buildings"). In the latter part of this paper, there are suggestions for the forms of agreement that are used between building owners or managers and telecommunication service suppliers (whom I refer to simply as "suppliers"). Also a new area of focus for the due diligence process is suggested.

Typically, the supplier wants to gain access to a building to bring wires or cables from the property line through an entrance duct to an equipment room (usually referred to as a "point of presence" room or a "POP" room) in a basement or similar area where a connection box or panel is to be situated for connecting distribution wires that will either already have been installed by Bell or another supplier in existing buildings, or that the Licensee wishes to install in the risers and conduits leading up to the several floors in the building. These distribution wires would lead to equipment rooms on each floor, and from there additional distribution wires would lead into the various leased premises on the floor. This would enable the Licensee to seek customers in the building who would obtain telephone and other communication services from it.

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[1] Speech "Green Light to Local Competition" F. Bertrand, Chairperson, CRTC, May 1, 1997, http://www.crtc.gc.ca/ENG/NEW/speeches/1997

The Real Sources of Value

Getting access to customers in buildings is the real source of value in the arrangement for the supplier, and considering the small area of the typical equipment room, the fee charged for use of the POP room and access to the risers, when determined as rental figure per square foot, having regard to typical rental rates for basement, equipment room, or storage space, would be low. Building owners are now aware of the large sums of revenue that are earned by suppliers of telecommunication services to customers (tenants) in their buildings. They also realize that there is now competition among local telephone exchange carriers, and other suppliers, as well as cable companies whose businesses are converging with the telecommunications suppliers. The ability of a building owner to limit or to grant exclusive access rights to suppliers creates new opportunities. As one might expect, this is out of harmony with the CRTC'S goal of encouraging competition and ensuring customer choice in order to facilitate lower rates, improved service and a robust telecommunication and broadcasting distribution industry. On the other hand, directly restricting building access fees chargeable by building owners is like expropriation. The CRTC prefers to avoid this, and has instead focussed on prohibiting the suppliers from agreeing to exclusive arrangements. To ensure that tenants in buildings would have the benefit of direct service from the suppliers of their choice, the CRTC, in Paragraph 206 of Telecom Decision CRTC 97-8[2] decided that a local telephone exchange company (often referred to as a "LEC") must ensure that customers are able to access services provided by any other LEC operating in the same area, and this must be done on reasonable terms and conditions. This recognized the fact that technology allows the same cable to be used by several suppliers to the same customers. It means that a supplier that a building owner permits to take wire into a building, can not enter into an agreement with the building owner not to permit other suppliers (competitors) to use its wire on reasonable terms.

This decision to require LECs to share their lines with each other generated debate about the particular point where this forced sharing should end in a building (the "service provider demarcation point"). Submissions were made by some, that the point should be at the telephone room on each floor. Others maintained that it should be at the customer's in suite phone room and still others thought it should be in the main terminal room. The location has major implications because the service provider demarcation point is that point at which the building owner can take control of the wire, thereby affecting access to tenants. Its location can deter, or facilitate higher building access fees.

In paragraph 32 of CRTC Decision 99-10 (August 1999)[3] it was decided that the service provider demarcation point would be moved to the main terminal room:

(a) in all new buildings;

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[2] www.crtc.gc.ca/ENG/TELECOM/DECISION/1997/D978.TXT

[3] www.crtc.gc.ca

(b) where the property owner provides a written notice for transfer of responsibility and control of in-building wire to the serving local exchange carrier; or

(c) where more than one local exchange carrier has installed feeder transmission facilities to the main terminal room in the building and wishes to use existing in-building wire, and the property owner accepts responsibility and control for it.

In paragraph 33 of the last mentioned decision it was confirmed that where a property owner accepts responsibility and control for in-building wire, it also assumes responsibility for managing those facilities. The term "in-building wire" is defined in that decision as follows:

> "wire and other facilities which are in the "MDU" [a multiple dwelling unit, but later expanded in a clarification letter by the CRTC, to include any multiple occupancy building], (e.g. wires in the MDU risers, running from the main terminal room to the telephone closet on each floor and from there to the customer's suite); in-building wire may be owned by a telecommunications service provider or by the property owner".

It should be apparent from these decisions that, in any new building, and in any building where the property owner is willing to assume responsibility for, and control of in-building wire, the building owner is in a position to control connection by its tenants to local exchange carrier services. It appears therefore, that the "gate-keeping" problem has not been addressed as directly or as completely as LECs would prefer.

Code of Conduct for Building Access

To ameliorate concerns about gate-keeping, the "Code of Conduct for Building Access"[4] was developed by a number of industry participants including the Building Owners and Manager's Association of Canada, "BOMA", and the Canadian Institute of Public Real Estate Companies "CIPREC", and various suppliers including virtually all the major ones.

Of particular interest is Part II which sets out an "Escalation Process" for dealing with complaints where a local exchange carrier believes that it is being discriminated against by a building owner. The process does not appear to have real sanctions and seems to be a kind of "motherhood" statement. Still, it does have persuasive effect and it should have some value in keeping building access fee rates to competitive levels.

[4] www.crtc.gc.ca/ENG/NEWSRELEASES/1999/R990908e.htm

It is the view of the CRTC that rates should be set so as to reflect the costs to the building owner of operating the in-building wire plus an administration fee, usually 25%. There is still a substantial amount of discussion concerning what "costs of operation" should be recoverable but it's a matter that must be left for later discussion.

The Burden of Control

There are certain aspects of assuming responsibility and control of in-building wire, in addition to the opportunity to impose access fees for connection to customers, that need to be considered.

Controlling in-building wire gives the owner the opportunity for minimizing the crowding of wires and cables within the ducts and risers of the building, and a better opportunity to manage access, supervise connections, minimize damage to wires that various contractors might cause, and a better ability to inventory, ensure labelling, and generally run the process efficiently. This also entails the responsibility of satisfying the service needs of tenants. Modifications, new installations and connections need to be attended to on a daily basis. Day to day management of the operation must be run in such a manner as to keep the tenants of the building happy. The option of simply saying "let Bell look after the matter" disappears. Those functions can also result in increased liability. For this reason, it is still unclear to most building owners whether it is in their interest to assume responsibility. I understand as well that Bell is more than happy to divest itself of responsibility because, maintaining a staff (at union rates) to service these requirements is expensive. A building owner needs to be careful before taking on this responsibility because, once it takes on the responsibility it can't change its mind unless it sells the building. Paragraph 36 of Decision 99-10 states that a property owner cannot relinquish responsibility and control for the in-building wire once it has been accepted. However, a property owner who has declined or not elected to accept responsibility and control for in-building wire can later decide to accept it. Paragraph 37 states that where the ownership of an "MDU" changes if a local exchange carrier owns the in-building wire any purchaser of the MDU can accept or decline responsibility, notwithstanding that the previous owner had assumed responsibility and control.

It is important to note that if the building owner owns the in building wire or has acquired ownership of it, the new owner must also assume responsibility and does not have the option provided for in paragraph 37 of declining that responsibility.

Riser Management Companies

There are several well known "riser management companies" in the United States and Canada that provide management and operating services in connection with in-building wires for building owners for a fee. It is reasonable to expect that more of this kind of arrangement will be seen. For each building, the need to ensure that the building owner has the flexibility of assigning responsibility for in-building wire to a riser management company or similar facilities management company, or to itself taken control should be evident.

It should be noted that the restrictions in CRTC Decisions 97 8 and 99-10 do not apply to all forms of telecommunication services. Rather, at this stage, they apply to voice grade copper and local dial tone services. They do not apply to data transmission, high speed phone, IST, or fax transmission, or other forms of communication that were not historically monopolized and which do not need the same competition enhancement as voice grade telephone services. On the other hand, as the telecommunication and broadcasting distribution industries converge, and as business becomes more dependent on these services, it is reasonable to expect that additional regulations may come forward. In addition, the flexibility of a building owner to manage communication infrastructure within the building, and, the need for tenants to obtain services at competitive rates will not change.

What is set out above is intended to serve as thumbnail sketch of the situation, and, to provide a context in which the specific, practical suggestions set out in the balance of this paper will make sense.

LICENSE AGREEMENTS

Here are some suggestions for access agreements used by building owners and suppliers.

1. The Form The form should be that of a license and not a lease. A building owner should avoid granting a leasehold interest. Exclusive possession is usually not needed or appropriate for the supplier. In addition, when selling a building, mortgaging or otherwise dealing with it, the covenants implied at law in leases, and the principles relating to the running of covenants are, generally not suitable for arrangements such as this. Also, the rights which tenants have to apply for relief from forfeiture, the technical requirements relating notice of defaults, and restrictions on termination tend to add confusion to the relationship. From the licensee's perspective, dealing with remedies such as distress, and trying to sort out the court's position concerning what constitutes breaches of quiet possession, fundamental breach, and determining when a landlord is required to mitigate damages is probably an unwarranted headache.

2. Special Considerations Many of the same matters that are dealt with in typical commercial leases, such as the term and renewals, fees, default remedies, notice requirements, obligations insure, and to repair, releases and indemnities, obligations for the licensee to adhere to building security requirements, restrictions on transfer, responsibility for utilities, insurance and similar matters tend to be covered reasonably well in typical license agreements entered into with suppliers. There are, however, some specific issues that need to be considered. These are addressed below.

3. The Fee Rate Clause Because of the uncertainty concerning what rulings the CRTC is likely to issue, and the uncertainty of predicting the permutations that are happening within the telecommunications and broadcasting distribution industries, setting a rate for the fees is difficult to do with any level of comfort. Therefore, provision needs to be made for the rate to be reviewed at periodic intervals (for example, two year intervals) and to have that rate

adjusted to reflect the "going rate" for comparable suppliers in comparable buildings. Even when the rate is established, the shadow of the CRTC and the potential for rulings that would cutback, over-rule, or invalidate agreed rates need to be considered. It is common to include a clause in which the parties acknowledge that they must adhere to CRTC laws and regulations and that to the extent any provision in the agreement is invalid or unenforceable the rest of the agreement will remain in place and, provisions will be enforced only to the extent that they are enforceable. The clause might also state that the owner may take steps or do things that the CRTC establishes to be permissible (for example acquire ownership of inside wire). An escape clause allowing the parties, or either of them to terminate the agreement on specified terms, should rulings make the agreement no longer viable might also be considered. An arbitration clause to deal with issues relating to interpretation of CRTC rulings, and policies and to sort out issues of viability and terms for termination might also be useful

4. Assumption of Control Clause It is important to reserve to the licensor (building owner) the right to assume control and management, and perhaps also ownership of, any in-building wire that is installed by the licensee so that the building owner can enter into facilities management arrangements ("riser management" deals), or itself take on the management and control if it determines that it is profitable for it do so.

5. Financing Restrictions This need to be able to take control or even ownership of in building wire also has implications for financing. If the supplier grants a personal property security interest in respect of in-building wires to third parties, this might impact the ability of the building owner to take control, or ownership of the in-building wire. Even if control is not taken, financing by the supplier could be a problem. If for example, the license agreement terminated and the building owner wanted to obtain the removal of the in-building wires, it would need to deal with the interest of the equipment lender. The equipment lender should be made a party to the license agreement, at least for the purpose of acknowledging whatever arrangements are made between the building owner and the licensee for removal, and use of that wire.

6. Liability Issues (Especially with "Hubs") If the in-building wire or other equipment of the supplier is damaged as the result of a fire or some other mishap, there is a potential for claims against the building owner, not only for damage to the property but also as the result of disruption to the customers within the building. Generally, this may be minimized by the exculpatory and indemnity clauses in the leases which the building owner gets tenants of the building to sign, and the exposure is no different now than it was when Bell had a monopoly. The greatest concern comes when the supplier uses the equipment room but as a "hub room" or a "switch hotel" housing equipment that is used to provide services not only to customers within the building but to various other customers in multiple locations within a network. When the equipment in such a room is damaged or malfunctions, the potential for claims against the building owner from a large segment of the public exists. Protecting itself against this liability is a challenge for the building owner. Some forms of license agreement

expressly prohibit the supplier from operating a hub, switch room, or similar type of facility on the premises for this reason. Generally, the liability insurance limits of a supplier imposed under the license agreement should be high (no less than $10,000,000.00) and, it is important to ensure that the building owner is added as an insured under that policy. That policy should also contain a strong indemnity in favour of the building owner against claims by third parties for disruption of service. This of course entails the liability policy containing a contractual liability endorsement. Where the parties do intend for a hub room or switch room to be operated on the premises, the building owner must take extra precautions relating to insurance, indemnity, and exculpatory provisions. The indemnity and exculpatory provisions need to expressly excuse the building owner from liability even if the people under its control are negligent. Without such an exclusion, the rate charged as a license fee would rarely be adequate to cover the additional liability exposure.

7. Rights of Termination Relocation etc. It should be obvious that rights of termination must be given to the building owner where major damage occurs to the building and, rights of relocation and perhaps even termination should also be provided for if the building owner wants to redevelop the building. It would also be prudent to include an express statement that there is no representation warranty or agreement that the building will be maintained at any particular occupancy level or that even the kinds of occupants within the building will not change. For example, a building owner may wish to convert an office building to a retirement home and, these changes would certainly affect the profitability of the arrangement from the licensee's perspective. From the licensee's perspective, a right of termination and the right to compensation for the unamortized costs of installations should be provided for in situations where the building owner elects to terminate the agreement due to changes in use of the building or redevelopment.

8. Transfer Rights and Restrictions These agreements need particular care in the clauses dealing with assignments, sublicensing, and other transfers. For example if a LEC is permitted to install in-building wire, and the building owner does not assume control of it, the LEC can not agree to obtain the building owner's consent before sharing the use of the in-building wire if the installed wire is voice grade wire. Nor is it clear that the LEC can require other LEC's to enter into an agreement with the building owner to be bound by the license agreement that the installing LEC signed. A clause allowing the building owner to refuse to permit a transfer, sublicensing, or co- sharing, in situations where the supplier is being paid value primarily due to the number and type of customers or potential customers in the building may be very important. However, at least where the service involves voice grade wire it might be enforceable. As the CRTC examines issues in the evolution of the industry, these provisions, even in agreements involving data transmission and other services that are not dealt with in the existing decisions of the CRTC may be invalidated.

It must also be remembered that a license, unlike a lease, does not bind subsequent purchasers of the building. Conversely, when a license agreement is assigned, the assignee is not bound by the covenants in the license agreement unless it enters into an agreement directly with the licensor. In fact a license, being a mere permission to use, is personal to the licensee, and can not be transferred or shared unless the licensor permits it. There is no presumption of transferability, as there is with leasehold interests.

DUE DILIGENCE ISSUES

What is set out above indicates certain matters that need to be considered in the due diligence process for a purchaser of a building, or a lender that is considering taking security on a building. Traditionally, there has been a tendency for a building purchaser or a lender to focus on the leases in a building in determining its value. As various telecommunication and other supplier agreements, and the ability to generate revenue from the customers in the building become more important, an analysis of the existing license agreements, and various other communication technology service supply contracts associated with the building should gain more importance. This analysis should take into consideration factors such as the following:

1. Are the rates of fees specified in the agreements actually recoverable and do they comply with CRTC regulations?

2. Are the agreements transferable to the purchaser and, conversely, does the purchaser have the right to terminate them.

3. Is there a potential for improving the fees on a transfer of the agreement by the supplier to another supplier?

4. Has a supplier been denied access to the building by the building owner, and has an "Escalation Process" been initiated as the result of a supplier complaint?

5. It is critical to determine who owns the in-building wire because, that would impact whether the new owner must take on the burden of managing the in-building wire or whether it has the option of electing not to do so.

6. Are there hubs or switch hotel rooms within the building and if so how does the license agreement deal with the liability associated with them?

7. Has the ability of the building owner to make alterations to the building been hampered by the license agreements?

8. Have components within the building been financed in favour of security holders whose security rights may interfere with the ability of the building owner (purchaser or lender) to deal with the building or the communication services within the building?

9. Have the various cables and wires installed within the Risers of the building and the various other items of communication equipment been properly labelled, identified and protected?

10. Is there a facilities or riser management contract in force and if so, is the revenue sharing structure incorporated within it a satisfactory one and is the scope of management services suitable? Is it terminable by the purchaser and if so under what conditions?

Caution

Since this paper has been prepared as part of "6 Minute" session, it is not exhaustive of complete. Its purpose is to highlight areas of concern for further focus. Additional items, no doubt, will be needed to be added to the list that is set out above before a suitable level of comfort can be achieved. In the meantime, it is hoped that this paper will be considered as a step in the right direction.

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