Indefeasible Rights of Use

UC2B IRU/Existing Infrastructure Committee

Drafted by Mike Vrem, from "Indefeasible Rights of Use in a Revived Telecommunications industry"

Revisiting the Treatment of IRUS in Bankruptcy Proceedings

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History Of IRUS

- FCC sought ways for carriers to compete with AT&T in the early 60’s
- Original Use was for Under Sea Cables and Satellite ventures
- Created an alternative to flat-rate lease line pricing creating a competitive, “pretend ownership” model
- Regained popularity in the early 1990’s with expansion of fiber optic networks
- Introduction of Telecommunications Act of 1996 ushered in an era of grand telecom ventures involving the use of the IRU

Consequences of Early IRUS

- As a result of the explosive growth of long-haul fiber routes, IRUs became the vehicle for trading capacity for many carriers
- What follows in early 2000's is a rash of telecom bankruptcies
- Questions arise as to contract status:
  - Executory (section 365 Bankruptcy Law, subject to rejection)
  - Share of Ownership (less risk, but subject to laws of the State of incorporation)

How an IRU Works

- Owner of Network is Grantor
- Grantor Pays Upfront for:
  - Rights of way, franchise fees & incentives to jurisdiction
  - Installation of conduit, fiber cable, labor, testing & etc., the make ready
- Grantor then assigns parts to Grantees for:
  - Dark Fiber: all rights to pump data, voice, etc. , including maintenance fees
  - Capacity: a select amount of bandwidth for similar rights as above but restricted to agreed upon bandwidth (includes transmission equipment)

Characteristics of an IRU

- Combines features of a sale, a lease, and a service contract
- May convey dark fiber, conduit, or high-bandwidth
- Is a form of acquired capital with grantee possessing an exclusive right and irrevocable right to use facility for all or most of potential life of facility
- Every IRU is unique, but typically confers usage rights to grantee but title and control remain with grantor
- Should a grantee wish to hold ownership interest, this is normally postponed towards the end of the term
- Actual title ownership is required to post as a capital investment, otherwise the transaction is treated as an expense

Treatment of IRUS

- Classification of an IRU has substantial impact
- The grant of a specific <u>asset</u> implies ownership, i.e. capital cost
- The grant of use, implies capacity or an <u>expense</u> item
- Maintenance payments may include: routine, preventive, and reactive
- Not included may be unscheduled, emergency, and/or relocation maintenance fees associated with cable cuts or cable relocations from public right of way for road, ROW, construction.

Secured Transactions

- Secured transactions or security leases if correctly structured may be exempt from Section 365 Bankruptcy Code (executory contract)

- Secured Lease requires the following:
  - Term is equal or greater than remaining economic life of the goods
  - Lessee is bound to renew for remaining economic life of the goods
  - Lessee has option to renew for no or nominal consideration
  - Lessee has an option to become owner of the goods for no or nominal consideration

- UCC factors for a lease:
  - Payment obligation is not subject to termination by lessee
  - Lessee is bound to renew lease for remaining economic life or become owner
  - Purchase option at end of lease term is nominal

IRU Drafting Recommendations

- Consider risk of bankruptcy when drafting IRU
- Construct IRU to resemble sale or capitalized lease
- Isolate maintenance and operational concerns separate from IRU (second document)
- Annual, on-going maintenance fees are a revenue opportunity and solidify the IRU
- "Magic words" need to be included to convey property rights and/or option to purchase goods at end of term
- Right to assign and right of access must be included
- Documents conveying the IRU should resemble a property conveyance

The End