

Doing the Greenfield Deal:

What Dev and Broadband Suppliers

Focused solutions to complex wired community transaction issues for MTUs and MDUs.

By Lawrence R. Freedman ■ *Partner, Fleischman and Walsh LLP*

Regulatory developments, market conditions, and new technology have created an unprecedented opportunity to build broadband communities. Developers of master planned communities and new multi-tenant properties, including condominiums, apartments, and offices, are venturing with broadband providers to construct FTTH and other networks.

What does each side in the transaction need to know, and what rights do end-users have under such agreements?

This article identifies from our experience the key transactional issues that all developers and service providers face when structuring a wired community arrangement. It is based upon the real-world experience of the author, who has counseled builders, developers, and service providers on a wide range of types and sizes of transactions all over the country, including some of the largest and most sophisticated wired community transactions to date.

Make no mistake. Such partnerships are changing the face of both telecommunications and real estate development. The most successful of these partnerships are not add-on, last minute deals. They reflect nothing less than a fundamental incorporation of technology and telecommunications in the development process.

Greenfield developers market the

availability of such arrangements as “wired communities.” Today, these wired communities are an interesting and still rare feature on the real estate landscape. Tomorrow, with the advent of a new generation of homebuyers and office tenants weaned on technology, and with continuing advances in broadband services, notably through fiber and Internet/Ethernet protocols, an increasing number of developers say such arrangements will be a competitive necessity.

As one prominent Virginia-based homebuilder and developer, Laurence E. Bensignor, principal of Van Metre Companies, noted, “Twenty years ago, people asked whether air conditioning was included with their new home. They do not ask that question anymore. [They assume it will be.] Twenty years from now, we believe they will have the same assumption toward connectivity and technology.”

With the cost of fiber coming down and with continuing advances in broadband content and services, many able providers have demonstrated the technical ability to deploy networks for wired communities.

The issue now turns to a larger challenge: Constructing a transaction in the marketplace that harmonizes the respective concerns of broadband provider and

developer. While developers appreciate the opportunity to offer a valuable amenity to their buyers and tenants (and perhaps to garner additional revenues as well), they want to mitigate risk and ensure that the telecommunications/technology transaction does not interfere with their core business of developing, selling and leasing real estate.

Similarly, in order for providers to offer state-of-the-art broadband, they need a transactional model that provides a sufficient return on investment in order to justify the cost.

The Legalities

The “wired community” model requires structuring a suitable strategic and legal arrangement between developer and telecommunications service provider to harmonize these fundamental concerns. These arrangements typically cover the construction, ownership, operation, and revenue sharing associated with the wired community system.

This is an attractive market entry strategy for service providers. It offers a unique opportunity for them to deploy FTTH or other broadband technologies throughout an entire community, in a greenfield environment. They are secure in the knowledge that they will derive significant revenue from each home, or at least the majority of homes, passed.

elopers Need to Know

The most successful [broadband provider-developer] partnerships are not add-on, last minute deals. They reflect nothing less than a fundamental incorporation of technology and telecommunications in the development process.

From the developers' standpoint, these arrangements increase the attractiveness of the developments to homebuyers and thereby enhance their value. In addition, they provide a revenue stream and potentially an asset that can be of significant long-term value.

With the success of a number of large projects over the past several years, wired community arrangements are moving from the realm of technical trials, where each project is a new adventure for all involved, and into the commercial mainstream. Accepted, "standard" arrangements and best practices are well on their way to being firmly established.

We are seeing arrangements with a variety of parties, including both local and national developers and builders on the one hand, and both regional and start-up provider companies as well as larger companies such as Verizon on the other.

The Need for a Thoughtful Transaction

The contractual provisions that are applied in wired community arrangements have become increasingly sophisticated over the past several years. The development of these legal provisions has coincided with two competing tensions.

While developers have recognized

that there is significant value and revenue associated with offering wired community features in new housing developments, this positive incentive is counterbalanced by a perception that some service providers may pose a risk of service reliability problems, corporate instability, and even bankruptcy.

There are also many regulatory issues that are as important to assuring the success of a wired community project as the hardware itself. These regulatory issues can place constraints upon the range of business options available to parties seeking to deploy facilities in new developments. They must be well understood and specifically accounted for when putting together wired community agreements.

Thus, wired community agreements require detailed legal mechanisms that allow both the developer and the provider to unlock the value associated with broadband, while limiting the risk. The strength and sophistication of these contractual provisions can go hand in hand with the physical infrastructure and technology in "making or breaking" a wired community transaction.

There are six core issues that come into play when structuring and negotiating a wired community agreement, and the resulting contracts are lengthy and complex.

1. Home owners' association (HOA) bundling or preferred provider agreements.
2. Competitor access.
3. Capital structure and return on asset.
4. Entity structure.
5. Service quality and carrier performance.
6. Default and remedies.

Each of these issues derives from the key concerns of the parties. The specific details of how parties address these issues to best meet the exigencies of a particular situation vary. As a result, the supporting contractual arrangements must be customized. Nevertheless, parties seeking to enter into a wired community arrangement should anticipate that they would need to address all of these issues to some degree. What follows is a brief overview of these issues and observations on how parties that have dealt with these in the past have addressed them.

HOA Bundling

One key issue that both developers and providers must agree upon is whether to require homebuyers to take (and pay for) the development's telecommunications services as a condition of purchasing a home with wired community facilities.

In a typical HOA bundling arrangement, the relevant homeowners associa-

One key issue that both developers and providers must agree upon is whether to require homebuyers to take (and pay for) the development's telecommunications services as a condition of purchasing a home with wired community facilities.

tion ("HOA") contracts with the entity that is supplying (or arranging for the supply of) the service (often a joint venture between the developer and service provider as discussed below).

The fees for these services are included as part of the regular HOA payment that all homeowners are required to remit periodically as a condition of residing in the community. Thus, fees for the fiber and the content are treated just like HOA fees for landscaping, tennis court maintenance, and other community amenities.

HOA bundling makes sense from the service provider's perspective. First, it ensures that the service provider will realize a revenue stream for every home passed. That stream is stable and can be calculated in advance. As a consequence, providers are better equipped to make rational business decisions based upon more realistic revenue forecasts. In addition, this model ensures take rates that most other providers can only dream of. This high take rate, coupled with strong margins on the high bandwidth services that are supported, makes this a very promising model.

Developers also gain through HOA bundling. First, because HOA bundling represents a more realistic long-term business opportunity for providers, it makes it much more likely that the provider will succeed and prosper. This benefits the developer by allowing it to provide homeowners with the much-anticipated and often promised services at a competitive price.

This addresses the developer's primary goal – namely selling houses and maximizing revenue while maintaining stability and customer good will. To the extent the services provide functions and value beyond those that consumers

could otherwise obtain, this factor, perhaps more than anything else, alleviates concerns about the mandatory nature of the services.

Second, where developers have revenue-sharing rights as part of the wired community arrangement, HOA bundling allows them to tap into this previously unavailable cash stream. This additional steady revenue could help developers better withstand any downturn in the business cycle. While this stream is seldom the sole deciding factor in whether a developer signs on to a wired community deal, it is a positive consideration from the developer's side.

It must be noted that HOA bundling can be controversial and has not been significantly tested yet by courts or regulators. It is quite a departure from the typical arrangement where each individual customer is used to choosing his or her own provider. This can lead to customer confusion and even legal problems if appropriate measures are not taken to avoid concerns in advance.

Indeed, where you use HOA bundling, it is critical to ensure that careful protections are in place, including that homebuyers have appropriate notice of the mandatory nature of the services prior to purchasing their homes, and, in addition, that performance is top notch. Sophisticated transactions reflect a multi-tiered approach involving marketing, land-record notices, provisions in community covenants, and direct customer acknowledgements to ensure there are no surprises regarding HOA bundling.

Performance promises are most helpful if they include specific and measurable benchmarks for the provision of superior broadband and other services to customers.

We are aware of numerous projects

using some form of telecommunications fees bundled within HOA dues. In several projects, for example, those fees are a direct part of the HOA assessment. In at least one project, the goal was to have the HOA simply guarantee the direct payments to the provider.

On the other hand, a number of providers and developers have determined that, instead of HOA bundling, they will use "preferred provider" marketing arrangements. These arrangements confer certain rights and obligations upon the provider and developer to allow first mover advantages, to do marketing, and to otherwise facilitate the provision of services in a particular community. But they do not go so far as to bundle the fees within the mandatory HOA assessment. Such marketing agreements offer a tradeoff in terms of economics and risk that each set of parties must balance in structuring a transaction.

One common HOA wired community scenario: Customers are offered at least two service packages.

1. The basic, and often mandatory service package, which includes telephone, multichannel video, and high speed internet; and
2. The premium package, which includes optional features and services not included with the mandatory service package.

Competitor Access

Should you make the provider's right "exclusive" and attempt to bar any other providers from serving the development? It should be noted that there are a number of regulatory proceedings underway that address various aspects of this issue. The focus of these inquiries tends to center on how best to harmonize the service provider's interest in protecting its investment, with the consumers' interest in choice, all while finding the proper way to promote facilities-based competition.

While this issue remains unsettled, in many states exclusive arrangements are entirely proper. The FCC has exempted incumbent telephone and cable companies from sharing most broadband facilities. Thus the FCC has agreed with the

underlying conceptual argument that providers cannot make the investment to support state of the art broadband unless they can have some assurance that they will not have to share the benefits of that investment with other providers.

Nevertheless, experience tell us under most circumstances there is no significant advantage gained by fighting to keep determined competitors out of a wired community. Many homeowners, and by extension, many builders, are more comfortable signing on to wired community arrangements where they have the option to choose alternative providers. One approach that permits customer choice while preserving the value of the wired community facilities is to permit, from day one, homeowners to have access to any other provider they wish. Some developers even put in place extra conduit for the express purpose of allowing alternative providers.

Note that where HOA bundling is in place, this does not relieve homeowners

of their obligation to pay for the network and services already in place. Nevertheless, they still have the option to choose an alternative provider. Conversely, competitors seeking to come onto the property to provide services are granted the right under appropriate circumstances. However, they are required to comply with reasonable rates, terms and conditions for such use, including the payment of reasonable compensation.

Capital Structure and Return

Wired community arrangements require the parties to agree upon a number of interrelating financial issues regarding capital structure, service prices, and revenue sharing. Typically, the parties mutually agree upon the appropriate pricing of services, as well as the procedure for adjusting those prices over time.

The goal is to ensure prices are competitive and for the homeowner or tenant to therefore realize better, cheaper service. In addition, the parties must negotiate

whether and how revenues derived from FTTH services will be shared.

These issues are complicated because the appropriate level of revenue sharing involves balancing several competing interests. The parties must be careful to create the proper incentive for the provider to install and maintain quality services, while also giving the developer the proper motivation to cooperate with the complicated and distracting tasks associated with implementing the wired community arrangements. These must be accomplished without driving the customer's price above a competitive level.

The question of who pays for the installation of the infrastructure is another primary consideration. These include a balancing and appropriate valuing of the contribution of the land and the appropriate easement and HOA privileges necessary for the provider to gain a first-mover advantage, along with the infrastructure.

Arrangements around the country have taken a wide range of courses, from

Multilet 

multilet.us
Ethernet over coax made easy. **Baseband**



Need an economical broadband Internet solution for small and mid-size MDUs?

Multilet eliminates the need for the high initial outlay of an expensive CMTS. Costs start low and scale with port count. All this, while providing industry leading features such as:

- ◆ Standards based Ethernet performance
- ◆ No active customer premise equipment
- ◆ High reliability - passive components

With thousands of lines installed worldwide, Multilet is a field proven system that can be relied on.

For additional information visit www.multilet.us or call us at (856) 795-9490.

www.multilet.us

splitting of costs, to providers paying all of the cost in exchange for the opportunity, to developers setting up a “pool” of funds for infrastructure purposes through lot fees and other means.

When planning the capital structure and putting together the associated legal documents, it is also important to address contingencies in the event either party seeks bankruptcy protection or otherwise is unable to meet its obligations. As everyone who has been involved with the telecommunications industry over the past several years is very aware, even the most capable and financially secure provider is not immune to financial problems.

Developers are particularly sensitive to concerns relating to continuity of service in the event the provider becomes unable to continue operations. Similarly, those who lived through the housing bust of the late 1980s can understand a service provider’s concerns regarding the long-term viability of developers, builders, and even banks. Accordingly, most wired community arrangements feature a number of provisions designed to reduce this risk. These arrangements are important elements to addressing the parties’ concerns and finalizing a wired community arrangement.

Entity Structure

One relatively new approach to entity structure in the wired community area involves the creation of a joint venture between the developer and the provider. This approach offers several key advantages. First, it permits a fairly fine tuned calibration of control between the parties. For example, issues such as which party will bear responsibility for day-to-day management and how the parties will review and approve major decisions can all be delineated in advance.

Furthermore, a joint venture can incorporate all of the normal attributes of a “vendor-customer” relationship, such as the amount of independent authority each party has and the approvals necessary for various key actions.

Moreover, the joint venture approach furthers bankruptcy planning objectives in several respects. Among many other things, the joint venture serves as a “layer”

between the developer and the provider, designed to prevent the direct entanglement of one party in the event the other files for bankruptcy.

For example, easements run (for the most part) to the joint venture, rather than directly to the provider, and terminate in the event of default by the provider. Furthermore, the developer never directly contracts with the provider; instead, such contracts are always through the joint venture. This limits the developer’s risk exposure in the event the provider defaults on its obligations.

As with the security deposit requirements, this has become a threshold issue that developers require to be addressed prior to agreeing to the deployment of wired community facilities. And, joint ventures have proved to provide a valid approach to maintaining control over access rights to the property.

Of course, there are other approaches. The joint venture is only one of many ways. Modern corporate laws embrace a wide variety of mechanisms that can be crafted to meet many different needs. The key is to identify the primary needs and concerns of the parties, and then craft the arrangements necessary to meet the specifics of the particular circumstance.

Service Quality

At the very least, a wired community arrangement must ensure that homeowners get services superior to those otherwise generally available. This ensures that the arrangement will provide value to the developer by differentiating the wired community from those developments with more traditional telecommunications.

This is particularly important where the services are a mandatory feature of the community. Recent wired community arrangements have included extensive contract language detailing the provider’s performance requirements.

The contracts typically feature a numeric “matrix” quantifying those contract provisions into specific benchmarks. These benchmarks provide objective measures for determining on-going compliance with predetermined performance standards through all stages

of system construction, operation, and maintenance.

This type of contractual mechanism is beneficial to both sides because it reduces uncertainty about the level of performance expected, whether the required level of quality has been delivered, and the recourse in the event the service quality standards are not met.

In addition it is increasingly important to structure the performance measure mechanism in such a way as to help ensure that the development remains “state of the art.” To this end, the wired community agreements should also include a process that allows the developer and the service provider to work together to develop and deploy appropriate system and service upgrades.

Default and Remedies

Both sides have significant investments at stake, and default is a disruptive scenario to all. Normal contract remedies to either “sue” or “terminate” may not be flexible enough to address the range of situations in a wired community. Consequently, innovative agreements in this area provide for a wider and more creative range of options, ranging from liquidated damages for minor issues to loss of exclusive or mandatory status to more serious issues.

The ultimate remedy of termination remains available, however, for the most severe defaults. Prepare for situations where the provider demonstrates a fundamental inability to provide quality and timely services to the community. In the event of termination, one of the notable options for the developer is to purchase the infrastructure at a predetermined, sliding-scale price based on when the agreement is terminated.

Those parties that can work through these issues in an efficient and successful manner stand to benefit from gaining access to a market with tremendous potential for growth. **BBP**

About the Author

Lawrence R. Freedman can be reached at Fleischman and Walsh LLP in Washington, DC, at 202-939-7923; lfreedman@fw-law.com.

Broadband Connectivity

For Cities & Communities

As the world's premier consulting firm focusing on city and community-wide integrated broadband planning, we work with developers, public officials and city planners to incorporate fiber-based broadband communications applications and services into their communities.

The Technology Master Plan™

To learn more about The Broadband Group and defining broadband connectivity, please visit:

www.broadbandgroup.com

Or call: (916) 614 9300

THE BROADBAND GROUP

