

Intersections Between Real Estate and Telecommunications: Turning Copper Into Gold

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Building owners are in the position today to reap additional income and value from their buildings through the surge in new telecommunications technologies and the demand for access to building tenants and users by an expanding number of telecommunications companies. The intersections between buildings and telecommunications are providing property owners with the ability literally to turn copper into gold.

1. The Demand for Telecommunications Services is Exploding.

The demand for high speed, broadband telecommunications is dramatically increasing, and the telecommunications industry is responding with new technologies at a faster pace. Tenants want Internet access, wireless telecom service, paging, cellular and traditional hard wired telecom services. Data transmission is now exceeding voice transmission across telecom lines. Data traffic is growing at an annual rate of 30% or more. Video conferencing is becoming more common as the technology improves, and video and audio messages are going to be an increasing part of email communications. Building owners are facing explosive growth in demand by their tenants for access to new telecommunications services, and demands for access by competing telecom providers to get to those tenants; these demands will only increase as the latest communications networks come on line, with telecom providers seeking more customers and with businesses demanding full-time Internet access and the right to choose among telecom providers.

2. What is Happening on the Technological Front?

A variety of technologies are available for broad bandwidth users that are creating greater demand by building tenants for access to telecommunications services. These new technologies will allow data transfer up to 25 times faster than the current rate for most users. Some of the technologies now being offered are:

A. Wireless Broadband -- Wireless competitive local exchange carriers (“CLECs”) offer telecom services to users at lower costs and at faster speeds than the incumbent local exchange carriers (“ILECs”). Wireless CLECs offer voice, data, local area network interconnections, video and other advanced uses. This technology uses microwave dishes to transmit wireless signals between a central switch and building rooftops that are within one to three miles of the switch. From the building rooftop, the signals are transmitted to users through existing wiring (fiber optic or copper) in the building.

In 1998, the Federal Communications Commission (FCC) auctioned a large spectrum of wavelengths for communications, permitting the wireless CLECs to offer “fiber-in-the-sky” quality service to users. The wireless CLECs, such as WinStar and Teligent, have increasing requirements for access to building rooftops to locate their antennae and

equipment in order to bridge the so-called “last mile” between their central switches and the buildings housing the users.

B. Digital Subscriber Line -- Both CLECs and ILECs offer Digital Subscriber Line (DSL) service. DSL provides advanced broadband telecom services over existing building wiring, allowing both voice and data to travel as digitized packets over the same analog twisted pair line. DSL service is less expensive than the T.1 lines currently being offered by most ILECs. However, DSL service is currently limited to areas within three miles of the provider’s central switch, so it is not offered in more outlying areas, and DSL is subject to technical limitations on the number of circuits available over the same wires. DSL providers have to access the buildings using either fiber optic cable or traditional copper wiring in the streets.

There are a variety of DSL technologies now being offered, with new ones being developed which will expand even more the bandwidth capacity of copper wires, making the existing wiring in buildings more valuable than ever to owners, tenants and telecom providers.

C. T-Carrier Lines -- T-Carrier lines are offered by most ILECs to provide broad bandwidth and speed over Category 5 copper wiring or fiber optic cable. There is a hierarchy of T-Carrier lines (T-1, T-2 and T-3) offering different transmission speeds. T-Carrier lines use a digital system carrying both voice and data. Like DSL and wireless services, T-Carrier lines make the existing wiring in buildings more valuable as competition for access to services increases.

D. ISDN Lines -- Integrated Services Digital Network (ISDN) service is offered by ILECs over the existing copper wiring. This was one of the first technologies offered by ILECs to increase data transmission over existing wiring. While ISDN technology does not have some of the technical limitations of DSL, it is becoming outdated in many areas as other services are becoming more widely available.

E. Cable -- With recent acquisitions and mergers in the telecommunications industry, it is clear that cable service will be a strong competitor for telecom users, with cable subscribers being able to use their cable not only for television reception, but also for full time Internet connection and telephonic and data communications. The cable industry infrastructure is not as extensive and reliable as that of the ILECs or CLECs, but cable service is often less expensive than DSL service (although there is heated price competition among DSL and cable providers).

3. Regulating the Rights of Building Owners, Tenants and Telecom Providers.

Federal and state regulators and the courts have issued regulations and made rulings that have significant impacts on the respective rights of building owners, tenants and telecom providers. One central issue is who has control of access to a building’s wiring, the crucial link between providers and the end-users of telecommunications services.

A. Demarcation Points -- In 1997, the FCC ruled that a building owner can declare the point where telecom wiring enters the building, known as the minimum point of entry (MPOE), as the “demarcation point”, marking where the owner takes ownership and control of telecommunications cabling. If the building owner or the ILEC declares the MPOE as the demarcation point, the owner takes ownership and control of the cabling inside his building, allowing the owner to set fees to telecom providers for use of the wiring and for the use of equipment rooms and the building rooftop and to control access to the building by telecom providers. At the same time, the owner also assumes responsibility for the maintenance and integrity of the wiring and may have potential liability to tenants for any failure in the wiring, depending on the language in the tenant leases.

The FCC has clarified that ILECs cannot unilaterally change the demarcation point to the MPOE (and thereby force a building owner to take responsibility for the building’s cabling and wiring), if the ILEC provided service to the building as of 1992, when the FCC initially issued its rules on demarcation points. The FCC does permit ILECs to establish the MPOE as the demarcation point in new or renovated buildings from and after 1992.

If the building owner has responsibility for the building’s wiring, the tenant leases should address the issues of who has liability for any service interruption, who maintains insurance on the wiring and how the cost is shared, and the allocation of responsibility between landlord and tenant for any work on wiring within or outside of a tenant’s premises, including rules on access to building telephone closets and risers.

B. Antenna Installation -- A 1998 FCC ruling expanded prohibitions on restrictions on antennae to include both residential and commercial property rented by the viewer. The FCC ruling preempts any lease restrictions that unreasonably restrict a viewer’s ability to receive a signal. However, reasonable restrictions by the building owners on antennae and equipment, such as limitations on changes to the building structure, and regulations protecting safety, are enforceable. The ruling does not allow tenants to use common areas (such as a building rooftop) to place antennae or equipment. Also, an owner may restrict the installation of individual antennae if there is a central antenna available to all tenants without unreasonable delay or expense.

C. Forced Access -- Prior to the Telecommunications Act of 1996, some states passed mandatory access laws or regulations to force building owners to allow competitive telecom services to their tenants. Texas, Ohio and Connecticut passed such laws, granting CLECs the right to access a building’s wiring infrastructure, on a non-discriminatory basis, in return for reasonable compensation. As many as 12 states are considering this issue; however, legislatures in Illinois, Colorado, Maryland and Indiana have rejected these proposals as violative of the United States and state constitutions. Congress rejected mandatory access laws when the Telecommunications Act was passed. In *Loretto v. TelePrompter Manhattan CATV*, the United States Supreme Court, in 1982, invalidated a mandatory access television cable statute in the State of New York, and courts have similarly rejected mandatory access laws for television cable and telecom providers over the past several years.

Most commentators believe that the Telecommunications Act of 1996 has created market forces sufficient to assure competition within the telecom industry, so that mandatory access laws are not necessary for a healthy competitive environment. In fact, there appears to be no greater competition among telecom providers in states in which mandatory access laws have been passed than in other states.

The California Public Utilities Commission (PUC) issued an order in October, 1998 that prohibited telecom providers (including ILECs) from entering into agreements with building owners that have the effect of restricting access by other telecom providers to a multi-tenant building. If a telecom provider is unable to reach a mutually satisfactory agreement with the building owner to permit access to the wiring, or if it claims it has been unfairly discriminated against, it can seek redress with a court or file a complaint with the PUC. The PUC also stated in its ruling that telecom providers that are “telephone companies” that have the right of eminent domain to gain access to private property to offer their services.

In response to this PUC ruling, Senate Bill 177 (Peace and Burton) and Assembly Bill 651 (Wright) were introduced in the California Legislature:

(i) SB 177 would eliminate the right of a telecom provider to use the power of eminent domain for competitive purposes, unless the provider has an affirmative obligation to provide telecom services and is seeking to serve an unserved area. SB 177 also prohibits exclusive telecom access agreements (which owners generally resist anyway).

(ii) While AB 651 was originally introduced to prohibit the PUC from adopting orders or making decisions that interfere with the ability of owners of private property to freely negotiate with telecom providers, it has been amended so it now would require building owners to allow telecom access to their buildings. AB 651 denies owners the right to allocate riser and closet space, denies owners fair compensation for space used by providers and imposes costs on owners for responding to provider access requests. This bill would also require owners of new buildings to provide space to accommodate all future telecom provider equipment and would permit the first provider in a building to grab as much space as possible, effectively shutting out future competitors from that building, who will need space in risers and closets.

These bills are now being considered by the California legislature and would have a dramatic impact on building owners in California, if passed.

4. **Important Business Issues for Building Owners and Managers and Their Advisers.**

It is imperative that building owners and managers review the physical infrastructure of their buildings and review their policies affecting telecom services to tenants. Real estate consultants who advise owners and managers need to be familiar with the new

telecommunications technologies and the options available to their clients in dealing with the demands of both telecom providers and the tenants/users.

A. Rooftop and Communications Closets -- Owners and managers should make sure they know what capacity and space their buildings have available for rooftop antennae and what areas can be used for supporting communications equipment. Owners of buildings with valuable rooftops must carefully allocate the rooftop area and available equipment room space among tenants and outside telecom providers for antennae and equipment only after careful study of the value of the rights being granted. Too often, owners and their agents give tenants rooftop antenna rights or rights to equipment rooms for little or no rental, giving up the right to significant future revenue streams from that space during the lease term. In addition, owners often undercharge for the use of their building infrastructure by telecom providers, on the basis that it is more important to offer the services to tenants rather than charge a higher fee for access to the building. With the proliferation of telecom service providers and the scarcity of prime rooftop space in many urban areas, building owners should be very careful not to give away valuable rooftop access or equipment room rights without a thorough understanding of the market for those rights.

Owners also must avoid giving one provider or one tenant rights to an entire rooftop or to all of the equipment space available: the space must be rationed so the owner retains the flexibility to offer space to new tenants or to introduce new services or providers to the building in the future, permitting future CLECs to compete for access to the building. Obviously, these issues are more important if the owner commits to telecom licenses for any significant term without early termination rights.

B. Risers, Shafts and Sleeves -- Owners and managers need to inventory their riser space and the cabling and wiring in the riser space so they can properly allocate the space to competing users. The vertical and horizontal pathways in buildings are the routes for telecom providers to access tenants for all technologies, whether it is over copper or fiber optic cable, and whether it is from a rooftop wireless antenna, a cable or a traditional telephone line. Consultants can assist owners in projecting future demand for building riser space and survey competing buildings to assign values to the use of the risers, so the owner/manager can properly allocate and charge for access to the space. Building managers should require tenants who vacate space or who replace their systems or telecom providers who are no longer providing service to the building to make sure decommissioned cable is removed from the building risers.

Long distance telephone companies, computer networks, wireless networks, CLECs, ILECs and Internet service providers all require access to riser space, but this space is finite and often cannot be increased without enormous cost to the building owner. Owners are now charging tenants separate rent for use of riser space in addition to rent for their premises, and are charging telecom providers for access to the riser space, in addition to charges for use of equipment rooms and rooftops. As new technologies come on line, the pressure on riser space will only increase, and owners need to retain the right to charge for access to that space in their leases, especially if the demand for riser space overtakes the supply.

C. Power and Cooling Capacity -- Owners/managers that are contemplating agreements with tenants or telecom providers that will permit access to equipment rooms, the rooftop and riser areas, must consider the electrical power and cooling capacity of the building. Telecom switches are high power users, generating significant heat in concentrated areas, often beyond the specifications for which building cooling and power systems were designed, especially in older buildings. This means that the power and cooling systems in the building may have to be upgraded (and air conditioning must often be supplemented with additional units) in order to accommodate the equipment that comes with the new telecom technologies, especially if the provider is locating a switch in the building. Owners should consult with their advisers and agents to determine the ability of owners in the local market to pass the costs of these upgrades on to the telecom providers.

In addition to demanding significant electrical power capacity from a building, telecom providers also often need access to an uninterrupted power supply (UPS) system and a backup emergency power generator, in order to assure their users continuous service even in local emergencies. If the telecom company is installing a major switch, it may want to install its own generator and UPS system, but this adds to the space requirements and may not be feasible in many existing buildings. Building generators can usually be dedicated to provide emergency power to specific tenants or telecom providers, but owners must carefully ration access to the limited generator capacity of their buildings to avoid depleting the power necessary for essential building functions and future demands by new tenants or outside providers. Any tenant or telecom provider who is given dedicated capacity from the building generator or UPS system should be charged for that access. Owners should have their consultants determine how to charge for this access in the local market: the charge could be based on the cost savings to the tenant or the telecom provider of connecting to the existing system as compared to installing a separate system, or the charge could be based on the actual cost to the owner of providing and maintaining the generator and UPS systems, including labor, depreciation and administrative costs and a profit factor.

D. Impact on Building and Tenants -- Owners and managers need to consider the impact of telecom agreements on their building and its tenants, beyond the obvious advantages of providing desirable telecommunications services. For example, owners should carefully analyze whether a proposed antenna will be visible from street level, or from other adjacent buildings, and whether such a visible antenna would detract from the value of the building. Also, the owner should consider issues of weight of equipment, safety of other activities on the rooftop (such as window cleaning equipment use), damage to waterproofing and the integrity of the rooftop (including by the penetration of the rooftop for cables and conduits) and any associated environmental concerns caused by the telecom equipment. Finally, consideration should be given to the perceptions of other tenants in the building if large portions of the office space in an office building are leased to telecom providers for equipment rooms, switches and the like: other tenants may perceive these uses as less desirable than office uses, which could negatively impact the value of the building.

5. **Important Legal Issues for Building Owners and Managers.**

Building owners and managers who are considering entering into an agreement with a telecom provider or a tenant to allow access to the rooftop or other area of the building for telecom purposes face all of the legal issues they deal with in leasing space to a tenant. In addition, they will face some issues unique to the telecom world:

A. **License vs Lease** -- A license is a contract right, and does not create a leasehold interest in the building. A lease creates a leasehold estate, giving the exclusive right of possession of the space to the tenant during the term of the leasehold. Telecom agreements with tenants and telecom providers are usually structured as licenses, and not as leases, because the area or space being provided for the antennae or equipment is often not exclusive (i.e., several antennae can be located in an area of the rooftop, multiple cables occupy the riser space, and more than one telecom switch may be located in an equipment room. If space is dedicated exclusively to the telecom company (e.g., where the telecom provider takes possession of a dedicated equipment room or closet), the agreement is often structured as a lease. Whenever possible, the owner will want to avoid creating a leasehold interest in favor of the telecom company and will want to grant only a license to use portions of the building for antennae, equipment, cabling and the like, so the owner, at least theoretically, retains the right to control the conditions under which the space can be used and to terminate the license if the conditions of use are violated, without the telecom company claiming the legal protections available to tenants. However, if the telecom agreement is structured as a license but ends up giving the user rights equivalent to a tenant, the agreement may be construed by a court as a lease, with the telecom company having a leasehold estate in the building.

B. **Permits and Approvals** -- Building owners and managers should require, in their license agreements with tenants or telecom companies, that the users assume all responsibility for procuring and maintaining in effect all permits and approvals required by any governmental authority for the installation and operation of the antennae and equipment. For example, in many cities, the installation of an antenna on the building rooftop requires the issuance of a Conditional Use Permit or other variance or permit. Also, FCC licenses are required to use telecom transmission equipment. Owners should consult with their lawyers or code consultants to determine if the telecom user is in compliance with the required permits, and the users should produce copies of the issued permits to the owners or managers for their approval prior to any installation of equipment.

C. **No Interference; Right to Relocate** -- The telecom licensee should be required under the license agreement to avoid any interference caused by its equipment or antennae with any other equipment or antennae installed in or on the building by other licensees. The license agreement should give the owner the right to relocate a licensee's antenna or other equipment to another suitable place on the rooftop or in the building if that equipment interferes with the owner's ability to provide space for future telecom users, as long as the operation of the antenna and equipment are not impaired.

D. **Term; Right to Terminate** -- One of the most important issues for the building owner and manager to consider in entering into a license agreement is what term the

license should have and what circumstances should permit termination of the agreement. If the license agreement produces significant revenue, the owner will want that revenue be included as part of the building's net cash flow for purposes of future loans or investments by third parties in the building. In this case, the license agreement should have a specific term so a potential lender or investor can count on the license revenue during that period. On the other hand, if the revenue from the license is not significant and the owner foresees increasing demand by telecom users for access to the building's rooftop, risers or equipment rooms, the owner will want to keep the term of the license shorter, or have right to terminate the license early or increase the license fee if the market license fees increase. For major telecom facilities, such as switch rooms or major fiber optic installations in a building involving a large capital investment, the licensee will generally insist on a longer license term so the capital investment can be recouped. Regardless of the term agreed upon with the licensee, the owner will need the right to terminate the license agreement upon a monetary or non-monetary breach by the user, or if the telecom facility is ever found to cause harm to tenants of the building or third parties (including, without limitation, through the release of any hazardous materials or other contamination).

E. Assignment and Subleasing -- The owner should retain the right in the license agreement to approve any transfer of rights, whether by assignment or sublease, by the telecom user. Owners often permit the licensee to assign the license as part of the transfer of all of its assets in a merger or sale, and where the applicable FCC license is transferred.

F. Costs and Liabilities -- The owners of Class A buildings can generally pass all costs of the telecom installation, and the associated costs of any telecom deals, including all installation costs, upgrades to building systems, permit fees, and operating costs of the telecom system, through to the telecom companies. However, some Class "B" building owners who seek upgraded services for their tenants have to pay CLECs to bring new telecom systems and services to their buildings, since the CLECs are not convinced that the tenant base will have adequate demand for their services. In a typical license agreement, the building owner is generally not obligated to make representations or warranties, or otherwise assume any liability to the tenant or telecom company, other than to permit access by the telecom user, on a limited basis, to the rooftop or other designated equipment areas of the building. On the other hand, the telecom licensee should give the owner and manager full insurance for its activities in and about the building, together with an indemnity in favor of the owner, the manager, their partners and any lender on the building.

G. Credit -- The credit of the telecom licensee must be evaluated by the building owner and manager before entering into a license agreement. The licensee's credit must be adequate to assure its performance of its undertakings under its agreement. Owners have learned that although there are some highly capitalized telecom companies, there are also many start-up telecom companies without any real net assets, many of whom will not survive as the industry matures. Owners of Class "A" buildings, where demand for access by providers is high, can be selective in dealing with telecom companies; owners of Class "B" buildings may not have the luxury of screening out the smaller providers, and thereby take a higher credit risk.

6. **Turning Copper into Gold.**

Smart building owners and managers consult with telecommunications experts to become familiar with the emerging telecom technologies and to determine how these technologies will intersect with their buildings. Owners and managers can create new revenue streams and add value to their buildings by leveraging off of the new technologies, whether by providing a rooftop antenna site, leasing out unused basement or mechanical floor space as a telecom equipment room, or licensing multiple telecom companies to have access over the building's cabling infrastructure.

Increasingly, owners are turning to telecom professionals, such as rooftop management companies, to market and manage the telecommunications facilities in their buildings. These professionals offer expertise not available to most building owners, allowing them to maximize the revenues from telecom opportunities. Many large property owners have brought the telecom expertise in house, and are undertaking regional or national programs to increase the telecom revenues from their buildings. Real estate investment trusts are permitted, under a recent[Internal Revenue Service Ruling,] to receive fees for providing telecommunication services to tenants without losing their REIT status, so long as the revenues do not comprise more than [25%]of their revenues. This Ruling will encourage REITs to explore more revenue streams from offering telecom services to tenants.

Real estate brokers and consultants can provide an understanding of the marketplace so the owner can accurately assess the value of each part of the building to tenants and telecom providers. Real estate lawyers should be consulted to assure that agreements with tenants and telecom companies are drafted with proper protections for the owner.

Through these steps, building owners and managers have opportunities like never before to perform the ultimate alchemy: turning their copper wire into gold.

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