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Key Contacts:

James N. Arbury
VP of Tax
jarbury@nmhc.org

Clarine Nardi Riddle
Senior Vice President
cnriddle@nmhc.org

Other NMHC Staff Contacts:

Douglas M. Bibby
President
dbibby@nmhc.org

David Cardwell
VP of Finance and Technology
dcardwell@nmhc.org

Kimberly D. Duty
VP of Communications
kduty@nmhc.org

James (Jay) Harris
VP of Property Management
jharris@nmhc.org

Eileen C. Lee
VP of Environment
elee@nmhc.org

Ronald G. Nickson
VP of Building Codes
mickson@nmhc.org

Mark Obrinsky
VP of Research and Chief Economist
mobrinsky@nmhc.org

**PERPETUAL EASEMENTS ON MULTIFAMILY PROPERTIES:
SIGNIFICANCE, CHALLENGES AND STRATEGIES**

By Pamela V. Rothenberg and Jacqueline P. Puentes

- Apartment community owner/managers are regularly raising questions about the differences between perpetual easements and exclusive contracts when negotiating with telecom providers.
- This white paper discusses the significance of exclusive contracts and perpetual easements, the challenges posed by those agreements, and negotiation strategies available to provide high quality services at competitive rates.
- Recommended distribution:
 - Chief Operating Officers
 - General Counsels
 - Ancillary Income Managers
 - Telecommunications/Information Technology Managers
 - Acquisition Specialists

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Based in Washington, DC, the National Multi Housing Council (NMHC) represents the interests of the nation's largest and most prominent firms in the apartment industry. NMHC members are engaged in all aspects of the development and operation of multifamily housing, including ownership, construction, management, and financing of rental properties.

The Council was established in 1978 as a national association to advocate for rental housing and to provide vital information to the leadership of the multifamily housing industry. Over the years, NMHC has evolved into the industry's leading national voice. The association concentrates on public policies of strategic importance to the industry, particularly in the areas of finance, taxation, property management, technology, the environment, and building codes. NMHC benefits from a focused agenda and a membership that includes the principal officers of the most distinguished real estate organizations in the United States. For those readers interested in joining the multifamily housing industry's leadership, NMHC welcomes inquiries to its Washington offices at 202/974-2300, or you can visit our web site at www.nmhc.org.

The NMHC Lawyers' Forum was created in 1998 to provide a forum for our attorney members to discuss emerging real estate issues. This monograph is part of a series of White Papers the Forum publishes on the most critical legal issues affecting the apartment industry. We hope that through this series we will be able to leverage the expertise of our attorney members in order to better help the busy apartment developers, owners and operators navigate in today's highly complex regulatory environment. Additional papers on a variety of topics will be produced over the course of the year. We hope you find them valuable, and we welcome your feedback.

ABOUT THE AUTHORS

Pamela V. Rothenberg, prothenberg@wcsr.com, and Jacqueline P. Puentes, jpuentes@wcsr.com, are members of the Real Estate Transactions and Real Estate Technology Groups at Womble Carlyle Sandridge & Rice, PLLC, where they handle transactions involving the acquisition, financing, development, leasing, workout, foreclosure and sale of apartment properties and other commercial real estate projects located in the Mid-Atlantic Region and throughout the country. In their technology practice, they advise real estate clients on the legal issues involved in developing and managing technology to maximize portfolio value. Their clients include owners, managers, developers and leasing agents, as well as lenders and other sources of funding for high-value real estate technology transactions.

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INTRODUCTION

Competition in the telecom sector is essential for multifamily owners to deliver high quality telecom services to their communities at cost-effective rates. In order to deploy state of the art services to their residents on the most favorable terms, it is crucial for owners to have bargaining power in the marketplace. This negotiating leverage is lost if owners do not have an opportunity to choose among a number of providers who are vying for the right to serve one or more of the owners' communities, and, consequently, who have the incentive to offer the owners high quality services at competitive rates.

Recent provider failures and consolidations within the telecom sector have significantly decreased the level of competition in the marketplace. In some locales, multifamily owners have only one option to bring mission critical video, telephony or data services to their communities – the incumbent local exchange carrier or the cable franchisee.

As incumbent carriers and franchisees gain increased market share, transacting with them is often a challenging experience for multifamily owners. One issue of paramount importance faced by owners in the negotiation of every telecom agreement is the type of legal rights the owners should grant in favor of the telecom provider. Owners continue to raise questions about the differences between perpetual easements and exclusive contracts. However, to effectively negotiate favorable agreements with telecom providers, owners must be aware of the importance and distinction between these critically different legal rights.

EXCLUSIVE CONTRACTS

An exclusive contract is an agreement entered into by an owner and a telecom provider in which the owner grants to the provider the exclusive right to deliver a specified set of services to one or more communities in the owner's portfolio. Current federal rules and regulations do not permit a multifamily property owner to enter into exclusive contracts for telephony (local dial tone or long distance) services with any provider. However, there is currently a distinct absence of such restrictions regarding video services.

Exclusive contracts typically grant providers rights in the form of a license. A license is a contract right, personal to the telecom provider, that permits the provider to access a community for delivery of specified services on the terms contained in the exclusive contract. A license is revocable – that is, an owner can terminate the license in the event of the provider's default or upon other circumstances defined in the exclusive contract. A license terminates at the end of the contract term, without the need for the owner to take any action to clear title to the property. Since these license rights relate to real property, the provider may not assign an exclusive contract without the owner's consent, which affords the owner greater control over the company that will deliver services to its residents.

When a community is subject to an exclusive contract, no providers, other than the provider designated in the exclusive contract, may access the community or provide services to residents. Typically, exclusive contracts remain in effect for a limited term, generally in the range of seven to ten years. It is important to note that exclusive contracts are not currently enforceable in those states where mandatory access statutes exist. In general terms,

mandatory access statutes prohibit a property owner from interfering with the franchisee cable operator's access to the property or its provision of services to the property's residents. Eighteen states currently have some form of mandatory access statute.¹

While mandatory access statutes preclude owners from entering into exclusive contracts for access to the property, they do not prohibit owners from entering into exclusive marketing contracts. Under an exclusive marketing contract, an owner can agree to market on an exclusive basis its provider of choice at the property. Oftentimes, in mandatory access jurisdictions, owners can utilize these types of exclusive marketing agreements to gain an advantage during their contract negotiations with the incumbent cable provider.

FOSTERING COMPETITION

In the video arena, to foster competition between the relatively few still economically viable competitive providers, on the one hand, and the franchisees, on the other, and to afford owners critically needed negotiating leverage in the marketplace, owners must retain the right to enter into exclusive contracts with competitive providers.

In exchange for the exclusive rights, exclusive contracts often contain favorable terms for the owner including, among other things, detailed service level standards with which the providers must comply and specific terms governing ownership rights in the equipment and wiring used by the provider to deliver the services. These favorable provisions are difficult, if not impossible, to achieve in contracts with franchisees, even when the franchisees have a monopoly yet, nonetheless, extract "exclusive" rights from the owner to provide telecom services to a community.

Exclusive contracts are critical for owners and private cable operators. They enable owners to attract competitive telecom providers to their communities by assuring these providers that they will have the right, on an exclusive basis, to solicit the community residents for service subscriptions. These exclusive rights assure private cable operators that they will not only recoup their substantial capital investment in the equipment and wiring required to deliver services to a community, but also make a reasonable return on this investment. Without such exclusive contracts and the resulting security of a steady customer base, these competitive providers have difficulty withstanding the economic pressures of competing against the local franchisees that generally have vast system deployment infrastructure.

Local cable franchisees are currently firmly entrenched and have great control over the multifamily cable service marketplace. They also benefit from having access to public easements and other resources, which are advantages unavailable to competitive providers. Under these conditions and without the possibility of an exclusive contract with the owner, a competitive provider has no reasonable basis to assume that it can achieve a return on or a return of its capital investment in a community.

¹ "Mandatory Access" States: Connecticut, District of Columbia, Illinois, Iowa, Kansas, Maine, Minnesota, Nevada, New Jersey, Ohio, Pennsylvania, Rhode Island, Texas, West Virginia and Wisconsin. The laws for these states vary with some having more impact than others.

PERPETUAL EASEMENTS

As multifamily owners endeavor to enter into exclusive contracts with competitive providers to bring telecom services to their communities, one obstacle they occasionally encounter is the “perpetual easement.” A perpetual easement is a right granted by a property owner in favor of another to use all or a portion of a parcel of real property for a particular purpose. These easements are recorded against the land and, therefore, cloud title to the property. They also run with the land and generally remain in effect “in perpetuity,” irrespective of whether ownership of the land changes over time. Typically, perpetual easements do not afford owners any termination rights, even in the face of a default by the provider.

Perpetual easements are property interests (as opposed to contract rights), and in the telecom world, they are typically very broad in scope, often grant exclusive rights to a provider that continue forever and are generally freely transferable by the provider. In the past, cable franchisees demanded that the owners grant them perpetual easements in return for the cable franchisees’ delivery of services to community residents. As a result, owners routinely recorded perpetual easements against their multifamily communities in favor of the franchisees. Community owners had little bargaining power vis-à-vis these franchisees and had no choice but to execute perpetual easements if they wanted cable service for their residents.

Despite still being relatively few, the number of competitive telecom providers has increased over the last 15 years and this increase is changing the negotiating dynamics. As a result, perpetual easements have largely become a thing of the past. A survey recently conducted by NMHC indicates that fewer than five percent of apartment communities are covered by perpetual cable TV video contracts.²

However, at the limited number of communities where they do remain in effect, perpetual easements are clearly unfavorable from a multifamily owner’s perspective. They not only prevent property owners from entering into exclusive license agreements with competitive providers, but they also preclude owners from signing non-exclusive license agreements with a different provider. Therefore, wherever possible, owners should attempt to have the franchisee release them from these easements, and there are a number of strategies owners can employ in an effort to do so.

NAVIGATING THE PROCESS

An owner will typically first identify the existence of a perpetual easement while in the process of performing its title review for the acquisition of an existing community or land for the development of a community. Often, the owner will ignore the perpetual easement in this process, since, at the time of the property acquisition, the owner does not perceive the perpetual easement to be a problem (and usually has bigger issues to resolve in bringing the acquisition transaction to closure).

² National Multi Housing Council, *NMHC Survey: Perpetual Video Contracts in the Apartment Market* (Feb. 1, 2002), available at <http://www.nmhc.org>.

The perpetual easement issue will likely rear its head again later when the community owner desires to enter into an exclusive contract with a competitive provider for video or data services. Alternatively, the owner will face the issue when the owner has amassed a sufficient number of units to do a "portfolio" deal with a competitive carrier and is blocked from doing so by the existence of a perpetual easement that affects one or more of its portfolio communities.

NEGOTIATING STRATEGIES

What actions can a community owner take if it encounters a perpetual easement that is impeding a transaction with a competitive carrier?

- First, the owner should review the easement to determine the scope of services the franchisee can offer and to assess whether the easement grants to the franchisee the right to deliver such services on an exclusive or non-exclusive basis. Unless the easement expressly affords the franchisee "exclusive" rights, then, generally, the franchisee may only offer its services to the community on a non-exclusive basis.
- If the franchisee's rights are non-exclusive, then the existence of the perpetual easement does not bar an owner from contracting with another competitive company. However, the agreement with the competitive provider may not grant exclusive rights to that provider. The agreement should also expressly state that it is subject to the terms of the perpetual easement.
- If the perpetual easement grants exclusive rights to the franchisee, the only way that the owner can contract with another competitive carrier is to request that the beneficiary of the perpetual easement release the easement of record.

What strategies can a community owner use with a franchisee to cause it to vacate a perpetual easement?

- The owner should contact the franchisee and explore the conditions the franchisee will impose to release the easement of record. Depending upon the circumstances, the owner may attempt to negotiate a cost-free release of the perpetual easement by the franchisee. This strategy can be successful if the franchisee is not currently providing services to a material percentage of residents in the community or has shifted its focus to a different marketplace, such that the perpetual easement in question is no longer significant to the franchisee. The owner may also be able to negotiate a buy-out of the perpetual easement for a set price payable in a lump sum or over time.

In exchange for the franchisee's agreement to release the perpetual easement of record, an owner may also consider:

- Offering the franchisee an exclusive contract for a limited term to provide the same services as those governed by the perpetual easement to the existing community, as well as one or more others in the owner's portfolio (i.e., communities the franchisee would not otherwise have a right to access) in exchange for terminating the perpetual easement.

- Giving the franchisee the right for a specified term to offer data or other communication services to the community that the franchisee would not otherwise have a right to offer absent the owner's agreement. In exchange for the right to provide these new services, as well as those services permitted by the perpetual easement, the franchisee may agree to release the easement. However, this may only be successful if the perpetual easement is narrowly written and does not already permit the telecom company to deliver any services to the community that the franchisee may from time to time decide to offer.
- Offering the franchisee a contract for a "portfolio" deal, under which the owner would grant the franchisee the right to deliver specifically defined services to all existing and future communities in the owner's portfolio for a limited term of years, in exchange for terminating the perpetual easement.

Under all circumstances, and as a fundamental strategy, each time an owner considers entering into a new transaction for any of its communities with a provider that is the beneficiary of a perpetual easement encumbering that community or a different community in the owner's portfolio, the owner should condition its willingness to complete the new transaction upon the franchisee's agreement to release the perpetual easement. If the complete release of the easement is not achievable, the owner should attempt, at a minimum, to narrow the scope of the perpetual easement by making it non-exclusive or by specifically defining the services the franchisee may deliver to the community.

SUMMARY

While franchisees are no longer requiring perpetual easements from owners as a condition to providing service to communities, they continue to retain substantial bargaining power over owners under the current adverse market conditions. Owners should proceed cautiously as they enter into new agreements with franchisees with a view toward avoiding contract provisions (like perpetual easements) that can have a long-term effect on their communities. If a franchisee insists that an owner grant an easement (as opposed to a contractual license) as a condition to its agreement to bring services to a community, the owner should be vigilant in narrowly defining the scope of this easement to permit the franchisee to deliver only specific services to the community, and requiring that the easement remain in effect only for a specified term of years (and under no circumstances in perpetuity).