

STANDING COMMITTEE REPORT NO. 20-09

RE: C.B. NOS. 20-15 AND 20-26/T&C

SUBJECT: BILLS PERTAINING TO FREE ACCESS
BETWEEN THE OPEN ACCESS ENTITY AND
FSM TELECOMMUNICATIONS CORPORATION
(FSMTC)

MAY 29, 2017

The Honorable Wesley W. Simina
Speaker, Twentieth Congress
Federated States of Micronesia
First Regular Session, 2017

Dear Mr. Speaker:

Your Committee on Transportation and Communications, to which was referred C.B. No. 20-15, entitled:

"A BILL FOR AN ACT TO AMEND SECTIONS 389 AND 391, AND INSERT A NEW SECTION 392, UNDER CHAPTER 3 OF TITLE 21 OF THE CODE OF THE FEDERATED STATES OF MICRONESIA (ANNOTATED) AS AMENDED, PERTAINING TO ASSETS AND LIABILITIES OF THE OPEN ACCESS ENTITY, AND FOR OTHER PURPOSES.",

and C.B. No. 20-26, entitled:

"A BILL FOR AN ACT TO AMEND SECTION 203 OF TITLE 21 OF THE CODE OF THE FEDERATED STATES OF MICRONESIA (ANNOTATED), AS AMENDED BY PUBLIC LAW 18-52, TO REQUIRE THE TELECOMMUNICATIONS CORPORATION OF THE FEDERATED STATES OF MICRONESIA TO PROVIDE SERVICES AND SYSTEM ACCESS ON THE HANTRU1 CABLE SYSTEM TO THE OPEN ACCESS ENTITY FREE OF CHARGE, AND FOR OTHER PURPOSES.",

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begs leave to report as follows:

The intent and purpose of these bills are expressed in their titles.

First Public Hearing on C.B. No. 20-15

Your Committee held a widely attended public hearing on C.B. No. 20-15 on May 18, 2017.

Because of the number of witnesses who appeared, your Chairman asked each witness to introduce himself and explain the role in which he was appearing before the Committee. Each witness did so. Among others, the following were present at the hearing to testify:

- Secretary of Transportation, Communication, and Infrastructure;
- Secretary of Finance and Administration;
- Attorney General;
- Assistant Secretary of TC&I in his capacity as both TC&I employee and as a member of the Board of the new Open Access Entity;
- TC&I Project Coordinator;
- Former Assistant Secretary of TC&I now retained by TC&I Division of Communication as ICT advisor;
- President and CEO of FSM Telecommunications Corporation (FSMTC);
- Two members of the Board of FSMTC;
- Legal counsel to FSMTC;
- Consultant employed by Macmillan Keck; and
- A member of the media.

Your Chairman began the hearing by stating that your Committee has been frustrated by the brinksmanship approach to legislation:

"Congress must do X, or the World Bank will not disburse the funds."

The Project Coordinator explained that the government made a commitment to reform the sector, but has "kicked the can down the

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road" with respect to hard decisions. He explained that "FSMTC can go wholesale or retail," but the World Bank will not release the funds until certain guarantees are in place. He explained that the original telecommunications liberalization bill called for the transfer of the HANTRU1 cable system, but that due to objections by FSMTC this was removed.

Members and the Project Coordinator then engaged in a discussion as to whether the Financing Agreement between the FSM government and the World Bank explicitly requires the transfer of legal ownership of the HANTRU1 cable. Members emphasized that the only mention of HANTRU1 in the Financing Agreement relates to FSMTC giving the OAE capacity and access "free of charge...on terms as may be demanded by the FSM Open Access Entity." Members noted that it seems that there is still wide disagreement between TC&I and FSMTC on this crucial issue.

Your Committee then asked TC&I to make its presentation about the bill. The Secretary of TC&I requested the Project Coordinator to speak about the bill. He explained that the World Bank had recently sent the FSM government a letter stating that there must be certain "guarantees" in place before the funds are disbursed. He then explained that the bill has three objectives:

1. FSMTC cannot compete with the OAE;
2. Provides a place for the OAE to land the new cables; and
3. Requires that capacity be used by FSMTC.

He explained that the passage of the bill would have very little or no economic impact on FSMTC because it provides FSMTC full access at very little cost.

Members returned to the issue of the transfer of HANTRU1 because the explanation did not clarify the confusion as to whether transfer is legally required.

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The Project Coordinator then explained that the wholesale and retail layers must be separated and that not transferring HANTRU1 would result in "regulatory nightmares and economic inefficiencies."

The Secretary of Finance and Administration then sought to respond to the concern of Members about whether the Financing Agreement requires the legal transfer of HANTRU1 from FSMTC to the new OAE. She explained that after Congress passed resolution C.R. No. 18-249, which accepted the \$47 million grant from the World Bank (the largest single grant in the history of the FSM), the FSM government signed a Financing Agreement with the World Bank. She explained that it was her understanding that the transfer of HANTRU1 is the last condition before the funds can be disbursed and that the money will not be released without it. She explained that without the release of funds, the FSM government would have a loss of \$10 million and be responsible to pay \$25 million.

Members again returned to the question of whether the Financing Agreement requires transfer of legal ownership of HANTRU1. The Attorney General was then asked for his legal opinion as to the terms of the Financing Agreement. He responded that before rendering a legal opinion he would need to review the precise language of the Financing Agreement on this particular issue. (See below for action taken by the Committee after the hearing to obtain this legal opinion.)

Members then raised concerns about whether FSMTC had been consulted about the terms of the Financing Agreement before it was signed and whether FSMTC had been consulted before the bill was transmitted to Congress. Members also inquired as to whether RUS, which holds the outstanding loan that FSMTC took to fund the purchase of HANTRU1, had agreed to the transfer required by the bill. Members noted that there seemed to be a great deal of confusion already surrounding the

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bill and its consequences.

At this point, your Committee asked the representatives from FSMTC to offer their perspective on the bill and the ensuing discussions. The FSMTC President began by stating that already during the hearing other parties had been making representations about the position of FSMTC with respect to the bill. He explained that FSMTC understands why there is a push for this bill because there is a large grant at stake and having access to fiber optic cable is highly desirable. However, he reiterated FSMTC's position, made known to the Executive in writing in November 2016, that FSMTC is not bound by the terms of the Financing Agreement. He further stated that nowhere in the Financing Agreement does it say that HANTRU1 must be transferred to the OAE.

For context, he explained that FSMTC has invested over \$120 million in the FSM building its network, and it has repaid over \$70 million to RUS on its two loans. He explained that these sums are tantamount to the sums of money at stake in the World Bank grant. He also stated clearly that passage of the bill would absolutely affect FSMTC's bottom line despite previous assertions by other parties to the contrary. He further explained that the national government would suffer a decline in gross revenue tax because the new OAE, unlike FSMTC, will not pay tax whereas FSMTC had paid in excess of \$1.5 million in GRT over the past four years.

With respect to C.B. No. 20-15, the FSMTC President explained that implementation of the bill would be extremely difficult because there are so many parties connected to the HANTRU1 cable system. For example, he explained that he sent a copy of the bill to MINTA, which responded that they are not interested in working with the new OAE because their relationship is with FSMTC, not a new entity.

He stated that all this bill does is disrupt FSMTC, compromise its

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ability to service customers, and cripple its ability to pay its loans to RUS. He stated that FSMTC does not want to be put in a position where it must take action against its major shareholder.

He further explained that, although the discussion had primarily centered on the transfer of HANTRU1, the bill also requires the transfer of FSMTC's satellite connectivity contracts. He explained that the transfer of these contracts raise a whole host of other difficulties.

He explained that FSMTC is willing to engage with the new OAE to explore how to meet the "free access" provisions of the Financing Agreement perhaps by pursuing some sort of "contra deal." However, FSMTC does not agree with the "hostile takeover" approach inherent in the bill. He concluded his comments by urging your Committee not to pass the bill.

Members then raised questions about the hiring of the new CEO for the new OAE. Members expressed concern that the new CEO would be paid in excess of \$300,000 per annum when the appropriation for the OAE was for only \$500,000. Members asked the Attorney General whether he had reviewed the contract; he replied that he had not. He also stated that it was his view that any contract must still go through the internal national government review process. Members inquired with the Secretary of Finance and Administration whether any of the \$500,000 appropriation for the OAE had been disbursed. They encouraged her to withhold disbursement until the Attorney General had rendered a legal opinion as to the validity of the contract.

By the conclusion of the hearing it was apparent to your Committee that, despite your Committee's exhortation to TC&I and FSMTC at the conclusion of its public hearing on proposed telecommunications restructuring on January 26, 2017, the parties have yet to agree on a constructive way forward. Members expressed the view that the

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parties should perhaps go back and meet "in the Micronesian way" to talk, listen, and iron out their differences before they return to the Committee. The parties should be encouraged to come back with something that will be good for all.

After the hearing your Chairman sent a letter to the Attorney General documenting the request for legal opinions on two issues:

1. whether the Financing Agreement (Palau-FSM Connectivity Project) between Federated States of Micronesia and International Development Association dated March 6, 2015 ("Financing Agreement"), specifically requires the transfer of legal ownership of the HANTRU1 Cable System from FSMTC to the new OAE; and
2. whether the OAE must comply with the standard national government procedures (e.g. review by Department of Finance and Administration and Department of Justice) before signing a management agreement or consulting contract.

The Attorney General's written legal opinion was received by your Committee on May 23, 2017.

Second Public Hearing on C.B. No. 20-15 and new C.B. No. 20-26
Subsequent to the hearing on C.B. No. 20-15 held on May 18, 2017, C.B. No. 20-26 was introduced and referred to your Committee.

After following up with the parties as to the status of their ongoing consultations, your Committee called for a second public hearing on C.B. No. 20-15 during which consideration would also be given to the newly introduced, but related bill, C.B. No. 20-26. This public hearing was held on May 25, 2017. Substantially the same witnesses appeared before your Committee to testify.

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Your Chairman opened the second hearing by stressing the seriousness of the matters under consideration and the need to find a solution. He requested both TC&I and FSMTC to update your Committee on the status of their consultations.

The Secretary of TC&I explained that he and the FSMTC President/CEO met on May 22, 2017. During the meeting he asked FSMTC to provide in writing an assurance they will provide HANTRU1 and satellite access to help meet the disbursement conditions. He explained that this assurance was needed because, despite previously supporting the World Bank project, FSMTC has now repeatedly stated that it completely opposes the project. He also explained that FSMTC is in the process of completing necessary agreements to provide the required access. Despite this, he maintained that C.B. No. 20-15 would ensure that the World Bank disbursement conditions are met.

Before hearing from FSMTC, members of your Committee posed a question to TC&I. Members inquired why TC&I took the rather large step to advance a legal transfer of the HANTRU1 cable (C.B. No. 20-15) rather than the more intermediate step of simply mandating access "free of charge" on HANTRU1 for the OAE. The Secretary explained that this large step was taken because FSMTC opposed the project in its entirety, and therefore the FSM government needed to force FSMTC to give the necessary guarantees of access to the World Bank. He maintained that passage of C.B. No. 20-15 would have no effect on FSMTC and would in fact even be advantageous to FSMTC because its costs would decline once another service provider entered the market.

The FSMTC President/CEO began by explaining that FSMTC has never stated that it opposes the project completely. In fact, FSMTC already accepted the existence of the OAE when it did not oppose passage of what became Public Law No. 18-52 (the liberalization bill). He also explained that he had just received a written

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response from RUS indicating that they would not be in support of a legal transfer of the HANTRU1 cable as required by C.B. No. 20-15. He indicated that passage of C.B. No. 20-15 would likely result in litigation given the number of parties connected to the HANTRU1 cable (RUS, MINTA, etc). He stated that NEC, the manufacturer of the cables, would likely not have signed a contract with the FSM if it had not been satisfied that the World Bank disbursement conditions could be accomplished without any additional legislation beyond the original liberalization bill (P.L. No. 18-52). He explained again that FSMTC would not block OAE access to HANTRU1 and that FSMTC would be willing to enter into "contra-deals" with the OAE. Given the ongoing consultations, he encouraged the Committee to take a pause and examine alternative solutions.

Members and the witnesses then engaged in a discussion about whether there were any other alternatives, besides C.B. No. 20-15, to meet the World Bank disbursement conditions. The responses from the witnesses from the Executive branch were confusing because one department (TC&I) stated that C.B. No. 20-15 was the only way and another department (Finance) implied that the World Bank had indicated a bill like C.B. No. 20-26 would be sufficient, although it would not be good for FSMTC financially. Members reiterated their concern that they are still not receiving consistent messages from the Executive branch.

Members then inquired whether passage of C.B. No. 20-15 would represent the "final step" in meeting the more than 20 disbursement conditions referenced in the World Bank's letter dated March 28, 2017. The TC&I Project Coordinator explained that this is the "most critical" and also the most politically controversial step. He explained that all the other conditions are "within the control of the project team" and that they have a "checklist" to ensure those conditions will be met. But he did indicate that, depending on the financial plan approved by the World Bank for the OAE, an additional

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appropriation by Congress from local revenues might be required. He also explained that, if the World Bank approves a new round of funding for the Kosrae-Kiribati-Nauru cable, a new financing agreement would need to be signed and that the new agreement would likely contain even more conditions (e.g. a requirement that competition actually be introduced before any money is disbursed).

Members and the witnesses then engaged in a discussion about the possibility of FSMTC and the OAE being a single entity. The Project Coordinator explained that the parties had worked on this approach for in excess of a year, but that the World Bank ultimately refused to accept this approach. He did indicate that if FSMTC in the future offered only "wholesale services," that perhaps FSMTC and the OAE could be combined. The FSMTC President/CEO indicated that both Tahiti and Australia have systems where the incumbent operator also functions as an "open access entity." The required "separation" is achieved through "accounting separation," which is the approach that FSMTC advocated for in the "white paper" they circulated as a response to the Macmillan Keck report.

Members also inquired whether it would be possible to come up with a bill that allowed reciprocal free access for both FSMTC and OAE.

Members then questioned the witnesses about various provisions in FSM's contract with NEC that might allow Congress more time to make a fully informed decision. Members asked questions related to the "60 day cure period" clause and the "no work stop" clause. Ultimately, the Project Coordinator stated that the FSM had not yet received a formal written "default notice," which is the document under the NEC contract that triggers the 60-day cure period. The Attorney General, although not familiar with the specifics of the cure period in the NEC contract, indicated that cure periods typically allow a party time to cure the default so the contract can continue on as if there had been no default.

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At the conclusion of the hearing, your Committee requested the parties to continue their consultations and to return to the Committee with a draft of a compromise bill satisfactory to both parties.

Third Public Hearing on both C.B. No. 20-15 and new C.B. No. 20-26

Your Committee held a third public hearing on Saturday, May 27, 2017, to hear once again from the parties as to whether they had agreed to a compromise bill. Substantially the same witnesses appeared to testify, but they were joined by the President's Chief of Staff.

The Chief of Staff updated your Committee on the progress the parties had made in the past two days. He reported that, although consultations are continuing, the parties had an agreement in principle on a draft IRU deed. He indicated that FSMTC thought the draft IRU deed was a workable agreement; however, the problem continues to be a shortage of time due to the end of the current Session on Tuesday, May 30, 2017. He stated that within the next few days either a final agreement on an IRU deed must be reached or C.B. No. 20-15 should be passed.

The FSMTC President/CEO stated that FSMTC only received a copy of the draft IRU deed on Thursday, May 25 after the second public hearing. He stated that an IRU deed is the type of agreement that FSMTC can work with because such agreements are common in the telecommunications industry. However, he expressed his concern that FSMTC was being pressured to sign a complicated legal agreement without sufficient time to conduct its due diligence. After a back-and-forth discussion regarding how long TC&I had had the draft IRU deed in its possession, the President/CEO stated that a similar document, the IRU deed between the FSM and Telin related to the Yap Spur, took nearly two years to negotiate. He indicated that he wanted your Committee to have this information as context for why

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FSMTC is insisting upon sufficient time to conduct its due diligence on the IRU deed. Finally, he stated that he had forwarded a copy of the draft IRU deed to both RUS and Armstrong, which is the entity that actually owns the HANTRU1 cable system.

Members informed the witnesses that time was growing short, and that it was their hope that the parties could reach an agreement in time to eliminate the need to legislate on matters that could be dealt with via contracts. Members raised the issue of why FSMTC had not been involved in the lengthy process of negotiating the terms of the draft IRU deed between the World Bank and the outside legal consultants retained by TC&I. Members then inquired if both TC&I and FSMTC could provide an estimate for date upon which final agreement on the IRU deed might be made. The witnesses from the Executive deferred to FSMTC. The FSMTC President/CEO explained that he is pushing hard to move this forward, but that the earliest he could expect a response from RUS would be Wednesday, May 31, 2017.

Members asked the witnesses whether execution of a final IRU deed would eliminate the need for Congress to legislate. The Chief of Staff explained that this was his understanding, but he again stressed that the deadline of June 30, 2017, was looming with respect to meeting the World Bank disbursement conditions.

Your Committee encouraged the parties to continue their consultations and to keep your Committee updated as to the progress towards reaching an agreement on the IRU deed. Members also encouraged all parties to be forthcoming in sharing all relevant information with the Committee and with one another in order to ensure the success of this very important project for the FSM. In the meantime, your Committee assured the witnesses that it would continue to consider the bills before it.

Recommended Amendments to C.B. No. 20-15

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As a result of your Committee's extensive hearings, your Committee recommends the following amendments to C.B. No. 20-15:

1. With the exception of the small technical amendment on page 2, line 13, the entirety of the new text in C.B. No. 20-15 will be removed;
2. On page 2, line 2, additional text will be added after the word "terms" so that the entirety of Section 2 will read as follows (new text proposed by your Committee is underlined):

"(2) The Open Access Entity shall provide international and domestic connectivity for the transmission of data for communications services as a wholesaler but not at retail. Such connectivity shall be provided on non-discriminatory and cost-based terms; PROVIDED, HOWEVER, that the Open Access Entity shall provide connectivity free of charge to the Corporation established by Section 202 of Title 21 of the Code of the Federated States of Micronesia from Pohnpei to Chuuk and Chuuk to Guam on terms substantially similar to those demanded by the Open Access Entity from the Corporation on the HANTRU1 Cable System."

Conclusion

Your Committee on Transportation and Communications makes the following recommendations with respect to the two bills:

1. C.B. No. 20-15, as amended above and in the form attached hereto, recommends its passage of First Reading and that it be placed on the Calendar for Second and Final Reading in the form attached hereto as C.B. No. 20-15, C.D.1
2. C.B. No. 20-26, recommends its passage on First Reading and that it placed on Calendar for Second and Final Reading in the form

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attached hereto.

If the parties (TC&I/OAE and FSMTC) reach a final agreement on the IRU deed, your Committee will reconsider its recommendation with respect to the two bills.

Respectfully submitted,

/s/ Victor V. Gouland
Victor V. Gouland, chairman

/s/ Alik L. Alik
Alik L. Alik, vice chairman

Florencio S. Harper, member

Ferny S. Perman, member

/s/ Dion G. Neth
Dion G. Neth, member

/s/ Wesley W. Simina
Wesley W. Simina, member

Joseph J. Urusemal, member