

## REPORT OF THE CHIEF EXECUTIVE

CABINET 24TH SEPTEMBER, 2008

### THE DELIVERY OF THE SOUTH YORKSHIRE DIGITAL REGION BROADBAND NETWORK (SYDR)

#### 1. Introduction and Purpose

1.1. In July 2005 Cabinet gave approval for Sheffield City Council to lead in the commencement of a procurement process to develop a Next Generation Broadband Access network across South Yorkshire. The key elements of that approval being;

- The entering into of an Agency Agreement with the other South Yorkshire Councils with SCC acting as agent. Under this agreement Sheffield has managed and resourced the procurement phase of the project on behalf of the 4 Authorities.
- SCC's contribution to the funding of the procurement phase of the project
- Authority to carry out a procurement exercise under the OJEU negotiated procedures and conclude negotiations with the selected preferred bidder.
- Authority to negotiate and enter into appropriate funding agreements.
- Authority to appoint appropriate external consultants.
- Report back to Cabinet at the appropriate stage of the project

1.2. That procurement process whilst extended considerably from the original timeline due to delays in putting together an appropriate funding package and progressing the funding applications, is now nearing completion and the purpose of this report is

- 1.2.1. **To update Members on the project setting out progress to date and future programme details.**
- 1.2.2. **To set out the business case and financial arrangements for progress to the implementation phase of the project and seek approval to them.**
- 1.2.3. **To describe the legal and commercial arrangements as negotiated with the selected preferred bidder Thales Transport and Security Limited ("Thales").**
- 1.2.4. **To describe the South Yorkshire Digital Region partnership working and governance arrangements including the establishment of a Special Purpose Vehicle ("SPV") to contract for and run the project.**
- 1.2.5. **To seek Member approval to the Council becoming a shareholder of the SPV , guaranteeing the obligations of the**

**SPV in proportion to its shareholding, and to appoint a senior officer to the SPV Board.**

**1.2.6. To seek member approval to the Council's share of the required investment funding**

## **2. Outcome and Sustainability**

- 2.1. The principal objective of the Digital Region project is to enable the transformation of the economic development and social prosperity of the South Yorkshire region through the availability of high speed, next generation broadband services to the public sector, to business and residential sectors.
- 2.2. It will bring forward investment in the ICT infrastructure in the area by 5 to 7 years giving the region technological and regeneration capabilities to equal the best in the UK.
- 2.3. The major benefits focus on jobs and additional Gross Value Added (GVA) contributed to the economy. The recent (October 2007) independent economic analysis carried out by DTZ (see Appendix C) states that the Digital Region project will enable the following numbers of jobs in South Yorkshire, particularly in ICT and businesses with greater use of digital technology –
- 2,500 over 3 years
  - 3,200 over 5 years
  - 4,700 over 10 years
  - 7,400 over 15 years
- 2.4. The analysis also states the Digital Region project will contribute an additional £198m p.a. in GVA, through growth in the ICT and digital sectors, and attracting inward investment to the region.
- 2.5. It is considered that the project will bring the following benefits:
- 2.6. For Households
- 2.6.1. Increasing ease of access – the convergence of computer, TV and phone, reducing costs
- 2.6.2. Increased access to employment and education from home
- 2.6.3. Increased access to public sector services from home
- 2.6.4. Community TV channels
- 2.7. For Businesses:
- 2.7.1. Access to a much larger market place through direct communication and interaction without taking any risk or increasing costs.
- 2.7.2. Will be able to receive an enhanced broadband product at significantly reduced rates against current prices, making implementation and ongoing costs more attractive.
- 2.7.3. Will have access to advanced applications including enhanced videoconferencing, 3D etc.

- 2.7.4. Advertising, home/flexible working, business support applications become more cost effective.
- 2.8. For the public sector
  - 2.8.1. Increased efficiency through a greater ability to support flexible/home working and reduced transaction costs
  - 2.8.2. Increased accessibility to the public through ease of communication, reduced requirement for face to face meetings and the promotion of community based TV channels
  - 2.8.3. Direct cost savings from use of the network
- 2.9. In creating this network based on a Fibre To The Cabinet (FTTC) deployment, South Yorkshire will be better positioned to develop to the next level of broadband capability through Fibre To The Premise (FTTP) in years ahead.

### **3. Executive Summary**

#### **Why?**

- 3.1. South Yorkshire is a region that requires social and economic development.
- 3.2. Such development has been proven to be substantially accelerated in areas across the globe by the investment in ICT infrastructure which will help to stimulate an e-economy.
- 3.3. Development of an e-economy will transform the region by bringing additional jobs in to the region and increasing GDP by creating an environment that encourages businesses and individuals to step-up to the next generation of electronic services.
- 3.4. However, as was the case in the initial roll-out of broadband infrastructure in the UK, South Yorkshire is likely to be in the last quarter of the country to benefit from such investment.
- 3.5. This project therefore seeks to use public funds to intervene in an area where there has been market failure and to buy a Next Generation broadband infrastructure that that will advance the region by 5 to 7 years putting it in the upper quartile for broadband capability and kick-starting it's transformation in terms of economic regeneration and social inclusion.

#### **What?**

- 3.6. South Yorkshire Digital Region (SYDR) intends to lay fibre optic cable, rather than use the existing copper, from the exchanges to the street cabinet (FTTC) and install VDSL equipment in a second street cabinet alongside BT's. The reliance only on short lengths of copper wire to the premise then means that high bandwidths can be downloaded and uploaded. This technology would allow speeds of 50mbps for all users with a guaranteed quality of service rather than an average speed currently available of around 6Mbps.
- 3.7. The proposed contract with Thales allows for the network to enable up to 97% of the population of South Yorkshire with a current BT connection to be reached.

3.8. As a result South Yorkshire will be the first sub-region in the country to enjoy the benefits of this technological advance.

#### **How?**

3.9. A Special Purpose Vehicle (SPV) will be formed, the members of which will be the four South Yorkshire Authorities and Yorkshire Forward. The SPV will enter into a contract with Thales Transport and Security LTD (Thales) who will build and operate the network and will provide Sales and Marketing services.

3.10. Thales will enter into contracts with Service Providers (e.g. Tiscali, Carphone Warehouse, Sky) for wholesale broadband services and they in turn will sell services to households, businesses and public sector bodies.

3.11. To fund the build of the network and the initial operating costs until such time as the SPV is self financing, the project will receive Grant funding from ERDF and YF totalling £44m and loan funding from the Local Authorities and Yorkshire Forward totalling £40m. In addition Thales themselves will provide £10m of loan funding.

#### **3.12. Sheffield City Council's role in this project is;**

3.12.1. **As a shareholder in the SPV; it will guarantee the performance of the company and will share in the surplus of the company in proportion to its 17% shareholding.**

3.12.2. **As a provider of loan funding; it will provide £4m of loan funding and will underwrite the repayment of the loan of £0.5m per annum should the SPV not receive sufficient revenue.**

#### **When?**

3.13. The start of the operational phase of the project is largely dependant on two work streams being complete; the first being negotiations with Thales and the second being the approval of funding applications from the Grant bodies.

3.14. The negotiations with Thales are expected to be completed by 30<sup>th</sup> September 2008 to enable a conditional contract to be entered into.

3.15. The funding approvals are expected to be complete by the end of November 2008.

3.16. The contract will become effective immediately after this point and deployment of the network which will be spread evenly across the sub-region will take 3 years.

3.17. The deployment of the network and in particular the extensive civil engineering work across the city will be co-ordinated with other projects such as the Highways PFI project to ensure that there is no unnecessary duplication of streetworks.

3.18. The contract will then operate for 10 years from when the network is fully working with an option to extend by up to 5 years.

## **4. Background**

4.1. South Yorkshire is a region that requires social and economic development.

- 4.2. Without intervention South Yorkshire is likely to be in the last quarter of the country to benefit from investment in next generation ICT infrastructure as it has to date.
- 4.3. Development of an e-economy will transform the region by bringing additional jobs in to the region and increasing GDP by creating an environment that encourages businesses and individuals to step-up to the next generation of electronic services. It is an essential component of the twenty-first century economy to match the Council's aspirations.
- 4.4. Today we operate in a global economy and South Yorkshire must kick start a new industrial position. The industry of the future is digital and this project gives the region an outstanding opportunity to be at the forefront. However it is considered unlikely that this opportunity will present itself through normal market conditions, as there are already significant digital sectors in the UK and beyond and the market will invest in those places first.
- 4.5. As jobs in traditional industries such as manufacturing continue to be in decline in the region and the country, a step change is required if South Yorkshire's economy is to be transformed.
- 4.6. Public Sector funding at this point to provide a new broadband infrastructure could advance the region by 5 to 7 years putting it in the upper quartile for broadband capability.
- 4.7. Officers of the South Yorkshire Authorities have worked with Yorkshire Forward and Objective 1 to explore the market position and technological developments, building a viable case for procuring the physical broadband infrastructure that will lead to transformation of the sub-region.
- 4.8. This culminated in the production of the South Yorkshire Business Plan considered by Chief Executives and Leaders of the 4 Councils in March 2005.
- 4.9. In July 2005 Cabinet approved the entering into an Agency Agreement with the other South Yorkshire Authorities for the purpose of managing and resourcing the procurement phase of the project with Sheffield City Council as lead Authority. Yorkshire Forward and Objective 1 have also provided funding for this phase of the project.
- 4.10. This procurement was completed in January 2007 with the selection of a consortium headed by Thales (with Alcatel and Kingston Communications as sub-contractors) as the preferred bidder.
- 4.11. Since this time a number of key activities have been progressed including;
  - 4.11.1. Detailed contractual negotiations with Thales
  - 4.11.2. Creation of a company limited by share (Digital Region Limited) as the SPV through which the project will be delivered.
  - 4.11.3. Negotiation and submission of funding bids
- 4.12. It is the latter of these that has led to considerable delay in moving from the procurement phase of the project to a point when Cabinet can be asked to consider the business plan, benefits and risks of moving to a full implementation of the project and closing a contract with Thales.

## **5. Project Description**

- 5.1. The objective of the project is to create a high speed, next generation broadband access network across South Yorkshire and to market this to Internet, Application and Entertainment Service Providers.
- 5.2. The proposal from Thales is to create a network based on fibre distribution rather than copper that will reach 97% of the population of the South Yorkshire region who are currently served by a BT connection.
- 5.3. This network will allow broadband speeds of 50Mbytes per second for all users with a guaranteed bandwidth and quality of service that are not available today.
- 5.4. To operate the network, Thales will create a Network Operations Centre based at their existing premises in Doncaster.
- 5.5. The Digital region SPV itself will be based at the Digital Campus in Sheffield.
- 5.6. It is anticipated that each of the 4 South Yorkshire Councils will migrate their existing services from their current provider on to the Digital Region network thereby providing a secure revenue stream for the SPV but also generating savings for the Councils on their current provision.

## **6. South Yorkshire Partnership and the SPV**

- 6.1. The work of the project, until September 2007, has been overseen by a Project Board representing Barnsley, Doncaster, Rotherham, Sheffield, Yorkshire Forward and Objective 1 supported by the Project Team. The Project Board met regularly to consider progress, project budget, manage project issues and risks, while giving guidance to the project team for the ongoing procurement and contract negotiations. This Project Board has been recently reconvened as a result of an acceptable funding package being developed with Stakeholders.
- 6.2. The South Yorkshire Chief Executives' Meeting has also been the focal point of decision making, with the focus being on:
  - the reduction of risk associated with the project, in particular the Business Plan,
  - the mix of funding to enable the capital investment in the project, and
  - the setting up of the Special Purpose Vehicle (SPV) to deliver the project and related issues of ownership and risk and reward.
- 6.3. Throughout the project there has been periodic reporting of progress on the project to the South Yorkshire Leaders' meeting and other appropriate forums.
- 6.4. In the period between now and the start of the project, consideration is being given as to the required governance arrangements that need to be in place to ensure a smooth transition to the proposed SPV.

6.5. To enable one single organisation to act on behalf of Yorkshire Forward and the 4 Local Authorities, and in order to comply with Local Authority Trading Legislation, an SPV has been formed. The main features of the proposed SPV are:

- The SPV will operate as a commercial business.
- It will contract with Thales through the execution of the Project Agreement and be responsible for monitoring the Project Agreement and the performance of Thales, as well as having sign off of the annual Business Plan, the strategy and any significant changes to the project.
- The SPV will be a company limited by shares and may have an associated charitable entity, which could be used for the distribution of profits.
- The first call on surplus revenues after covering contract and SPV operating costs will be the repayment of any Local Authority investment.
- It will have a board of directors, including an independent chairperson, senior officers from each of the Local Authorities and Yorkshire Forward and non-executive directors from appropriate commercial organisations and partners.
- There will be a Chief Executive and an operational team of approximately 15 people.
- It is proposed that one Local Authority will undertake a monitoring role on behalf of the other Authorities which will report on the performance of the company and audit the company's finances on a regular basis

6.6. Share ownership and voting rights in the SPV will be split as follows;

- 6.6.1. Yorkshire Forward 50%
- 6.6.2. Sheffield City Council 20%
- 6.6.3. Barnsley Metropolitan Borough Council 10%
- 6.6.4. Doncaster Metropolitan Borough Council 10%
- 6.6.5. Rotherham Metropolitan Borough Council 10%

6.7. Underwriting of the SPV's obligations and subsequently any sharing of any surplus will be split in the following proportions.

- 6.7.1. Yorkshire Forward 40/70ths
- 6.7.2. Sheffield City Council 12/70ths
- 6.7.3. Barnsley Metropolitan Borough Council 6/70ths
- 6.7.4. Doncaster Metropolitan Borough Council 6/70ths
- 6.7.5. Rotherham Metropolitan Borough Council 6/70ths

6.8. Surplus revenues will be available for distribution from the SPV after the payment of –

- 6.8.1. Contract costs payable to Thales
- 6.8.2. SPV running costs
- 6.8.3. Taxation
- 6.8.4. Loan repayments & interest (including Thales loan)

- 6.8.5. Thales Revenue Share
- 6.8.6. Additional network build costs beyond first phase commitment.
- 6.9. Surplus revenues may be distributed through a charitable trust if the SPV board consider this to be the most efficient mechanism for tax or other purposes.
- 6.10. As noted above, it is proposed that the Council appoints a Senior Officer to serve as a Director on the SPV Board.

## 7. Legal and Commercial Proposition

7.1. It is proposed that subject to the satisfactory finalisation of contract negotiations, the SPV will enter into a conditional contract with Thales comprising a Project Agreement and its associated Schedules. These documents are at an advanced stage of completion and a summary of the key aspects of the legal and commercial arrangements contained in these documents is set out in Appendix A to this report . The conditional nature of the contract is principally about the need to secure funding for the project from Yorkshire Forward and ERDF before the contract can become effective. It will also have to take account of any conditions that might be imposed as part of the offer of funding. Such conditions precedent are described in more detail in section 11 to this report.

## 8. Funding Arrangements

### 8.1. Basic Project Structure

The project is modelled on a three year build out (access available to approx 97% of the population of South Yorkshire with a BT copper connection) followed by a ten year operational phase.

The model is based on a level of revenue generation commencing in quarter 3 of year 1 and stepping up during the first 5 years reaching a cash positive position in year 4.

In this model, the Service Provider revenue is forecast to grow over the life of the contract to approximately £36m p.a. based on a take up of 21.3% of the total population.

On this basis the gross funding requirement including deployment, operating and SPV costs will be approximately £112m funded by:

Source	Amount	Type of Funding	Drawdown Priority	Repayment Priority
ERDF	£30m	Grant	First	NA
Yorkshire Forward Single	£14	Grant	Second	NA



Pot				
LA Loan Funding SCC £4m BMBC £2m DMBC £2m RMBC £2m	£10m	Unsecured loan	Joint Third	Primary
Yorkshire Forward Loan Funding	£30m	Unsecured loan	Joint Third	Subordinate to LA Loan
Thales	£10m	Unsecured loan	Joint Third	Subordinate to LA & YF Loan
Net Trading Income Received	£18m	Income received from Service providers during deployment period	Assumed to commence in quarter 3 of the contract	NA

**N.B. The above table reflects the expected type and priority of repayment as this is still to be finalised with each of the funding bodies.**

8.2. Whilst funding applications have been submitted and initial approvals cleared, the exact details of the funding offers from each of the providers has yet to be finalised in terms of the confirmed amounts, timing, draw down eligibility, outputs, claw back etc.

8.3. Only when these issues are satisfactorily resolved and final approvals are received will the contract become effective between the SPV and Thales..

8.4. Further details as to the timing and split of funding are contained in Appendix B.

## 9. Apportionment of Risk

9.1. Detailed risk registers for the project are contained at **Appendix C**, however the key risks are described below.

9.2. There are a number of risks leading up to the commencement of the contract which could have a significant impact on the viability of the business case and/or the project timetable. The most critical of these risks are;

### 9.2.1. Project Financing

The model is sensitive to the amount, timing and eligibility of ERDF, YF and Local Authority funds and the terms on which they are made available. If the assumptions cannot be achieved then this could impact on the business case.

#### **9.2.2. SPV Formation and Operation**

The contract can only be signed when the SPV structure is finalised and appropriate guarantees in place. There are significant obligations on the SPV as soon as the contract commences with regard to control and approvals, and therefore it is particularly critical that a clear, robust and well resourced client structure is put in place with the necessary governance structures back into the Council. This will include a specific Local Authority monitoring role that is contained within the Shareholders Agreement. If the necessary resource and expertise is not available then the project and the SPV are at considerable risk.

9.3. The key risks that the SPV will be carrying throughout the operation of the contract are set out below. Any additional costs/funding shortfalls as a result of these risks will have to be covered by the guaranteeing parties to the SPV.

#### **9.3.1. Increases In Cost Assumptions**

Whilst the majority of deployment and operational costs are fixed, there are possible increases as a result of surveys and inflation which could exceed the business case assumptions.

#### **9.3.2. Demand**

**This is by far the biggest risk that this project carries. The risk that sufficient revenues will not be received from those using the network to fund the initial investment and pay for the ongoing operation of the business over the contract period. This risk will only be mitigated when Service Providers commit to the network through entering into Access Agreements. These agreements are generally 12 month rolling contracts and so the risk remains with the SPV throughout the contract period. Whilst this risk rests predominantly with the SPV, Thales do carry a degree of the risk in that the repayment of their £10m loan will be dependant on the success of the business and further they only recover the costs of the sales and marketing service through the revenue share arrangements if sufficient revenue is generated.**

#### **9.3.3. Funding / Claw Back Risk**

ERDF funding is likely to be subject to specific conditions in terms of the achievement of outputs. Failure to achieve outputs within the required timescales could result in claw back of some or all of the funding.

#### 9.3.4. Residual Value

The business case assumes that the value of the network can be used to offset any financial exposure carried by the stakeholders and that the grant providers will have no rights over those assets. The value of the network is based on estimates which it is not possible to validate.

9.4. All other risks in relation to costs overruns, delays and performance of the network rest primarily with Contractor. However these can impact on the reputation of the network and thus impact on demand.

9.5. It should be noted however, that there is also a risk to the region of doing nothing. In the first roll-out of ADSL enabled exchanges by BT several years ago, there were no exchanges in South Yorkshire in the initial phase of the deployment and the sub region as a whole was not covered until some considerable time after the first more commercially attractive areas..

BT's most recent announcement (15<sup>th</sup> July 2008) to deploy a fibre to the cabinet capability in the UK could leave the region further disadvantaged. The deployment is unlikely to be across the UK as a whole and if the previous pattern is repeated in terms of roll-out, South Yorkshire is unlikely to be a priority area and it so the gap between it and those areas which are covered will widen further.

### 10. Programme Plan

10.1. The key programme milestones achieved to date are set out below:

- Appointment of Project Manager; July 2005
- Appointment of external advisors; July 2005
- Finalisation of Agency Agreement by the 4 South Yorkshire Authorities; August 2006
- Signature of Objective 1 and Yorkshire Forward funding agreements by SCC; July 2005
- Agreement of stakeholder requirements and output specification for the project; August 2005
- Determine appropriate commercial structure for the project post contract award; August 2005
- Detailed Invitation to Negotiate; September 2005
- Published OJEU Notice; September 2005
- 70 bidders short listed to three; November 2005
- State Aid approval; November 2006
- Preferred bidder selected; January 2007
- ERDF Operational Programme launched; January 2008
- ERDF Major Project Submission; 19th June 2008
- ERDF PMC Meeting, 24th June 2008
- Yorkshire Forward Board approval; 25th July 2008

- Rotherham MBC Cabinet Approval ; 30<sup>th</sup> July 2008
- Informal ERDF submission to European Commission; 1<sup>st</sup> August 2008
- South Yorkshire Programme Monitoring Board; 7 August 2008
- Barnsley MBC Cabinet approval; 13<sup>th</sup> August 2008

10.2. The key project milestones through to Contract Award' are as follows:

- Sheffield Cabinet approval 24 September 2008
- Completion of negotiations with selected bidder, Thales Transport and Security Ltd; September 2008
- Commence recruitment for SPV; August 2008
- Local Authority Gateway Review; 12 September 2008
- Yorkshire and Humber Programme Management Committee; 17th September 2008 (to approve ERDF major project application)
- Formal ERDF consideration commences; 18th September 2008
- Inaugural SPV Board Meeting; w/c 22 September 2008
- CPRG & Treasury Approval; September 2008
- Conditional Contract Award; 30th September 2008
- Yorkshire Forward get Secretary of State approval to section 5(2)(c) powers to become member of SPV; November 2008
- EU Major Project Approval; November 2008

## 11. Conditions Precedent

11.1. The contract, which will be conditional, will only be awarded when the following matters have been properly resolved::

11.1.1. Project Agreement and Schedules Satisfactorily Complete  
Whilst the Project Agreement and Schedules are substantially complete, there is further work required to finalise these. Only when these are complete to the satisfaction of the Project Board/SPV in terms of the balance of risk, level of control and deliverability, will the contract be awarded.

11.1.2. SPV Set up satisfactorily complete  
Whilst a draft set of documents has been developed which sets out the roles and responsibilities of the members of the SPV, these have yet to be finalised. Only when each of the Authorities and Yorkshire Forward have agreed a final structure and appropriate governance arrangements for the SPV and it is appropriately formed, guaranteed and resourced will the contract be awarded. This includes Yorkshire Forward's ability to participate in the SPV itself following a section 5(2)(c) approval from the Secretary of State.

11.1.3. Loan Agreements complete  
Each of the parties will enter into loan agreements with the SPV. Contract Award will be conditional on having all of these agreements in place.

#### 11.1.4. Business Case Assumptions Sufficiently Validated

The Business Case for Digital Region is dependant on the commitment of Service Providers to migrate to the Network at an early stage and to grow the market for next generation broadband services.

Discussion with a range of Service Providers has been ongoing throughout this procurement process and will continue. It was a requirement of the approval given by Cabinet in July 2005 and it remain the case currently, that evidence (preferably letters of intent) should be sought from the market as to the likelihood that the demand assumptions are valid in terms of speed of take up and product mix.

11.2 It is proposed that, as a result of all of the required approvals not being in place at contract close, such approvals and consequent conditions of delivery become 'conditions precedent' to the effective operation of the contract, that is the contract will only become effective once such approvals have been received on satisfactory terms. These are identified below:

#### 11.1.5. YF Single Pot Funding Satisfactorily Agreed

Whilst the amount of funding from each of the Authorities allocation of single pot funds has been agreed in principal, further work will be required to clarify the terms of the funds and for the applications to achieve full approval. Only when formal offer letters have been received from the relevant body and the terms of the offers are acceptable will the contract be effective.

#### 11.1.6. ERDF Funding Satisfactorily Agreed

Whilst the amount of funding from the Objective 1 allocation of ERDF funds has been agreed in principal, further work will be required to clarify the terms of the funds and for the applications to achieve full approval. Only when formal offer letters have been received from the relevant body and the terms of the offers are acceptable will the contract be effective.

#### 11.1.7. Positive Outcome from Gateway Review

It is a requirement of the Project Board that a further external Gateway review be carried and that the project receives a positive outcome from that review before the contract becomes effective.

11.2. It is proposed that the preceding two points will form Conditions Precedent within in the Project Agreement with Thales and only when they are satisfied will the Project Agreement become operative.

11.3. It is likely that there will be a time limit within which such conditions have to be met for the terms of the contract to remain valid.

## 12. Financial Implications

12.1. It should be noted that the following financial implications are based on the proviso that:

- All assumptions included within the current business case are achieved with the main assumptions being around demand risk and residual value of the assets;
- The proposed contractual arrangements are completed in accordance with the Council's current understanding;
- Formal approval / confirmation of all funding streams is granted.

12.2. The Council's share of the funding requirement is **£4m**. It is proposed that this will be made available to the SPV as a loan and will be funded through prudential borrowing.

12.3. In the event that the SPV meets the business case assumptions in terms of revenue generation then the drawdown of that funding is as follows;

<u>Year</u>	<u>Investment</u>
<b>2009/10</b>	<b>£1,652k</b>
<b>2010/11</b>	<b>£2,348k</b>

12.4. If the business case is achieved then repayment of the Council loan will commence in year 4 (2011/12) and could be complete by year 8 (2015/16).

12.5. The worst case in terms of paying back the loan is that insufficient revenue is generated to repay loans in which case the Council will underwrite its own loan repayment. The annual costs to the Council of this underwriting, assuming payment of capital and interest over ten years, will be

<u>Year</u>	<u>Financing Costs</u>
<b>20010/11</b>	<b>£175k</b>
<b>20011/12 to 2020/21</b>	<b>£530k p.a.</b>

12.6. The interest rate on the loans to the SPV will be fixed at contract award based on the prevailing PWLB rate for a ten year loan. The Council will carry the risk on any movement in those rates between contract award and the point at which it enters into the loan agreement with PWLB (or other source of funding).

12.7. In addition the Council will be required to provide a guarantee to cover the performance of the SPV in proportion to its share of the initial investment. This means that in the event that the SPV does not generate

sufficient revenue to cover the contractual payments to Thales and the SPV's own operating costs, the Council will be liable for a proportion (12/70<sup>Th</sup>s) of any shortfall.

12.8. It is not possible at this stage to quantify the impact of the underwriting on the Councils revenue account as this will depend on an assessment as to the probability of liabilities arising under the guarantee. The likelihood of the revenue assumptions being achieved will be monitored as we begin to get some meaningful response/commitment from Service Providers and this will continue on an ongoing basis as part of the governance of the project and provisions will be made in the accounts where appropriate.

12.9. The following examples show the effect of a reduction in revenue due to slower penetration of take up of services over the network and the resultant amount of additional funding to be provided by SCC;

12.9.1. Penetration growth at 25% below base case assumption (15% by Year 4)

<u>Year</u>	<u>SCC Additional Funding</u>
2010/11	£102k
2011/12	£693k

12.9.2. Penetration growth at 50% below base case assumption (10% by Year 4)

<u>Year</u>	<u>SCC Additional Funding</u>
2010/11	£600k
2011/12	£1,359k

In each case the additional funding requirement would continue on an annual basis for each year that penetration remained at this reduced level. However if there was no likelihood of take up recovering to modelled levels beyond the initial periods then the SPV would be able to terminate the contract incurring break costs as detailed below.

12.10. In the event that it is not viable for the business to continue, termination of the contract will result in breakage costs being payable to Thales which the Council will also underwrite. The following is an estimate of the Councils share of the likely break costs in each year.

	Year 1	Year 2	Year 3	Year 4	Year 5	Year 6	Year 7	Year 8	Year 9	Year 10	Year 11	Year 12	Year 13
	2008/9	9/10	10/11	11/12	12/13	13/14	14/15	15/16	16/17	17/18	18/19	19/20	20/21
£000													
SHEFFIELD													
Break costs	-857	-1,908	-2,777	-857	-686	-514	-343	-171	-171	-120	-86	-51	-34

12.11. It is assumed that if there is business case failure that there would not be any claw back of ERDF or YF Grant funding and that neither body would have a call over the assets created.

12.12. However, the funding from the Council will contribute to the creation of an asset which the SPV has an option to take ownership of and which it is assumed will have a residual value. It is assumed that the value of the asset will be used to reduce the liability of each of the shareholders. Details of the Residual value assumptions are contained in Appendix E. Based on these assumptions the net exposure to the Council is as follows:

	Year 1	Year 2	Year 3	Year 4	Year 5	Year 6	Year 7	Year 8	Year 9	Year 10	Year 11	Year 12	Year 13
	2008/9	2009/10	2010/11	2011/12	2012/13	2013/14	2014/15	2015/16	2016/17	2017/18	2018/19	2019/20	2020/21
SHEFFIELD													
Loan Underwriting	0	(1,652)	(4,000)	(3,652)	(3,284)	(2,895)	(2,485)	(2,052)	(1,594)	(1,110)	(599)	(59)	
Revenue Underwriting	(0)	(464)	(1,303)	(1,738)	(572)	(448)	(465)	(491)	(436)	(391)	(347)	(303)	(529)
Break Costs	(857)	(1,908)	(2,777)	(857)	(686)	(514)	(343)	(171)	(171)	(120)	(86)	(51)	(34)
<b>GROSS EXPOSURE</b>	<b>(857)</b>	<b>(4,024)</b>	<b>(8,080)</b>	<b>(6,247)</b>	<b>(4,542)</b>	<b>(3,858)</b>	<b>(3,293)</b>	<b>(2,714)</b>	<b>(2,201)</b>	<b>(1,621)</b>	<b>(1,031)</b>	<b>(413)</b>	<b>(563)</b>
Residual value	276	5,200	9,060	10,123	9,671	9,220	8,768	8,317	7,866	7,414	6,963	6,511	6,060
<b>NET RESIDUAL (RISK)/VALUE</b>	<b>(581)</b>	<b>1,176</b>	<b>979</b>	<b>3,876</b>	<b>5,129</b>	<b>5,362</b>	<b>5,475</b>	<b>5,603</b>	<b>5,665</b>	<b>5,793</b>	<b>5,931</b>	<b>6,098</b>	<b>5,490</b>

12.13. Based on the above scenarios, if there was business case failure and the contract was terminated at year three and if there was no residual value in the assets, then the Council's total exposure would be £8m. The annual costs to the Council of this underwriting, assuming payment of capital and interest over ten years from 2011/12 would be £1m per annum.

12.14. Based on the modelling assumptions contained in the business case, a summary of which is contained in Appendix E, the SPV will be in a cash positive position by year 4 and will generate surplus revenues by the end of year 13 of £58m. Any such surplus will be shared between the shareholders in proportion to the shareholding in the SPV.

12.15. It is assumed that the South Yorkshire Authorities will begin to migrate their network usage from existing providers onto Digital Region network from quarter 5 of the contract (currently assumed to be Oct



2009). The Council has allowed for this event in its Outstanding Sheffield Programme and talks will be initiated with the OSP shortlisted bidder(s).

- 12.16. Based on the costs assumed by the OSP bidders for alternative provision, it is envisaged that using Digital Region will result in significant annual savings.
- 12.17. In addition the Council should also benefit from savings from transferring the schools provision from the current provider.
- 12.18. The extent and timing of such savings can only be quantified when the detailed requirements of the OSP programme and schools contract are understood.

### **13. Legal Implications**

- 13.1. Cabinet, in its previous consideration of this project, took the view that the provision of a greatly enhanced Broadband infrastructure within Sheffield and the rest of South Yorkshire would promote the economic and social well-being of Sheffield. Furthermore, this report suggests that the project might also contribute to the environmental well-being of the city by, for example, reducing the number of commuter journeys. If Cabinet holds the view that participation by SCC in the project is likely to achieve the promotion and/or improvement of the economic, social and/or environmental well-being of Sheffield and its residents then this would be permitted by the powers to promote such well-being conferred by Section 2, Local Government Act 2000.
- 13.2. These well-being powers must be exercised by reference to any guidance issued by the Secretary of State. This has been considered in the preparation of this report and in the development of the project, and there is nothing within these proposals which is at variance with the guidance.
- 13.3. Additionally, when exercising its well-being powers SCC has to have regard to its sustainable community strategy ('the Sheffield City Strategy' prepared pursuant to Section 4 of the 2000 Act). It is believed that the proposed project would help the further achievement of the strategy. One of the "Big Ambitions" in the strategy is "for Sheffield to have an economy that matches the best in Europe". A priority within the strategy is to "increase connectivity and information and communications technology infrastructure". The strategy also recognises the importance of climate change issues.
- 13.4. In order for any public sector support for the project to be lawful, it is essential that European State Aid rules are not breached. Accordingly

efforts have been made to structure the project in a manner that has regard to State Aid rules, and following an application for State Aid clearance confirmation has been given by the European Commission that the public sector support for this project, whilst constituting State Aid, is permissible.

- 13.5. If the project is successful there is the prospect of SCC receiving a significant financial return on its investment. Conversely, SCC will be bearing a share of the financial risk of the project being a commercial failure. Clearly SCC will wish to be in a position to benefit from the profitability of the business that is being created. The Section 2 well-being powers cannot themselves be used to “raise money”. However, the Local Government Act 2003 and the Local Government (Best Value Authorities) (Power to Trade) (England) Order 2004 do authorise a “best value authority” (such as SCC and the other three South Yorkshire Councils) “to do for a commercial purpose anything which it is authorised to do for the purpose of carrying on any of its ordinary functions”. These functions include the promotion of well-being pursuant to Section 2. “Commercial purpose” basically means with a view to profit.
- 13.6. Before exercising this ‘trading power’ the authority must prepare and approve a “business case” in support of the proposed exercise of the power. This must state:-
  - 13.6.1. the objectives of the business;
  - 13.6.2. the investment and other resources required to achieve those objectives;
  - 13.6.3. any risks the business might face and how significant these risks are; and
  - 13.6.4. the expected financial results of the business, together with any other relevant outcomes that the business is expected to achieve.
- 13.7. This report, with its appendices, therefore constitutes the business case which Cabinet is being asked to approve.
- 13.8. The trading power must be exercised through a company within the meaning of Part V of the Local Government and Housing Act 1989. The proposed SPV fulfils this requirement. Any requirements imposed on the SPV by Part V, or the Local Authorities (Companies) Order 1995 made thereunder, will be observed.
- 13.9. A best value authority has to recover the costs of any accommodation, goods, services, staff etc that it supplies to a company in pursuance of any agreement or arrangement to facilitate the exercise of

the trading power conferred by paragraph. This requirement will be built into any arrangements with the SPV.

13.10. There are legal issues in establishing the SPV, but its formation as a body with limited liability is designed to limit the risks, both commercial and operational, to the partners. The other main legal issues in the SPV set up are contractual terms in the project agreement with Thales and exit arrangements at the end of the contract term or at an earlier stage if there is considered to be business case failure. These are described more fully in section 7 of this report and the appendices. The Council will not be a direct signatory of the contract but it will have obligations and liabilities through the arrangements established for the underwriting of the project, through membership of the SPV.

13.11. If a best value authority becomes a 'zero star' authority as a result of a CPA assessment basically it loses the trading power referred to above. This has necessitated some complex arrangements to cater for the unlikely eventuality of one or more of the four Councils having to withdraw from the SPV for this reason. These have not yet been finalised but the basic principle is likely to be that in such a situation, the exiting council's share of any guarantees given, but also of any future profits, would be shared proportionately between the remaining councils.

13.12. Before exercising the trading power regard must be had to any guidance issued by the Secretary of State on the use of the power. This has been considered in the preparation of this report and in the development of the SPV proposals and the wider project.

#### **14. Human Resource Implications**

14.1. There are no employee implications arising directly from this report, other than the need for appropriate input of officers into the project on technical, regeneration, procurement, legal, commercial and financial issues.

14.2. Additionally a Senior Officer is required to serve on the SPV Board as the Councils nominated Director and this will require appropriate insurance to cover such liabilities as may arise.

#### **15. Environmental and Sustainability Implications**

15.1. As part of this project and in support of the ERDF funding application, Yorkshire Forward commissioned an Analysis of the Environmental Impact of the Digital Region to be carried out. A summary of the key findings of the report is contained at Appendix E. The report also contained a number of recommendations for ongoing actions to ensure environmental best practice and legality.

15.2. Where the recommendations rely on the performance of Thales and its sub-contractors then these will be reflected as appropriate in the obligations under the Project Agreement.

## **16. Equality of Opportunity Implications**

16.1. Consideration has been given to equality of opportunity implications in the project throughout its design.

16.2. This was considered as part of the selection process and forms part of the contractual obligations contained in the arrangement with Thales.

16.3. The SPV will adopt an equal opportunities policy which will be in line with that of SCC.

## **17. Recommendations**

**Cabinet is recommended:-**

**17.1. Having had regard to SCC's sustainable community strategy ('the Sheffield City Strategy') and to the guidance issued by the Secretary of State about use of the powers to promote well-being contained in Section 2, Local Government Act 2000, to confirm its belief that participation by SCC in the South Yorkshire Digital Region project as envisaged in this report is likely to achieve the promotion and improvement of the economic, social and environmental well-being of Sheffield and its residents;**

**17.2. To note the commercial nature of the project and, having had regard to the guidance issued by the Secretary of State about use of local authority trading powers, to approve SCC's continued participation in the project, including (but without limitation):-**

**17.2.1. SCC becoming a shareholder in the SPV that will act as the project delivery vehicle, and subscribing such capital in return for its shares as the Chief Executive shall consider appropriate;**

**17.2.2. SCC acting as a guarantor of the SPV's obligations; and**

**17.2.3. SCC generally entering into such agreements and/or arrangements connected with the project, and on such terms as the Chief Executive, in consultation with the Director of Corporate Resources and the Assistant Chief Executive, Legal and Governance, shall consider appropriate;**

**17.3. To support the progression of the project into its implementation phase and approve the commercial and investment**

**arrangements as outlined in this report (subject to caveats within the report and in particular the Conditions Precedent at section 11);**

- 17.4. To note and approve the business case for the project set out in this report and the financial implications of the project, including prudential borrowing of £4 million to fund SCC's share of the overall investment in the project;**
- 17.5. To authorise the Chief Executive to exercise on behalf of SCC SCC's rights as a shareholder in the SPV including (but without limitation):-**
- 17.5.1. the giving of any required consents;**
- 17.5.2. representing (or appointing a suitable individual to represent) SCC at SPV general meetings; and**
- 17.5.3. appointing a suitable senior officer as SCC's nominee on the SPV's board of directors;**
- 17.6. To authorise the Chief Executive generally to take such further steps to progress the project or to safeguard SCC's interests in relation to it as he shall consider appropriate, including making changes to any of the proposed arrangements described in this report which he may consider to be in the Council's interests or necessary to conclude negotiations with third parties, provided that any such changes shall be made in consultation with the Director of Corporate Resources, the Assistant Chief Executive, Legal and Governance.**
- 17.7. To authorise the Chief Executive generally to take such further steps to ensure the progress of the project is co-ordinated with other projects such as the Highways PFI project to ensure that there is no unnecessary duplication of streetworks.**



## Appendix A

### Summary of Legal and Commercial Proposition.

#### 1.0 General

The Project Agreement will be between Thales Transport and Security Limited (the Contractor) and the SPV (the Customer).

Thales will build and operate and manage the network and will carry out sales and marketing activities in order to secure contracts with service providers ("Service Providers") for the use of the network.

The Contractor's primary obligation under the agreement is to build and operate a network with the capability to reach 97% of the population (with a BT copper connection). The Customer may elect at a given decision point to limit the deployment to give a reach to a pre-determined 80% of the "connected" population if it believes it is prudent to do so.

Whilst the network at full capacity can reach 97% of the connected population, the core infrastructure deployment in the first instance will be based on a minimum capacity (i.e. to achieve connectivity to approx. 13.6% of the population). The capacity will be increased incrementally as demand is proven, subject to the approval of the SPV.

Thales will provide £10m of loan funding to the SPV repayment of which will be subordinate to the repayment of the Local Authorities and Yorkshire Forward funding. In addition they will not receive direct payment for the sales and marketing services but will receive a share of revenues only where revenue generated exceeds an agreed threshold.

#### 2.0 Network Implementation

The Customer and Contractor will agree an Initial Deployment Plan in advance of Contract Award. This will be developed into a more detailed deployment plan within 4 months of the commencement of the contract.

It is the responsibility of the Contractor to carry out the implementation to the agreed specification in line with all applicable legislation and to obtain any necessary consents.

Payment for the Pre-operational phase of the contract will be subject to completion of agreed milestones which will have to comply with an agreed process of acceptance testing which will be approved/carried out by the Customer.

Any delays to the achievement of milestones, which are the fault of the Contractor, will result in a withholding of payment and in some circumstances to Delay Payments being made to the Customer.

The Contractor will enter into Access Agreements with Service Providers or the Local Authorities to provide access to the network. The form of the Access Agreements and the conditions therein will be agreed with the Customer.

At an agreed decision point, the Customer may suspend or cancel further deployment of the network or terminate the agreement if the Customer reasonably believes that the Network will not provide the benefits envisaged or will not meet the Business Case. The first of these reviews will be 30 months after the commencement of the project and thereafter project progress will be reviewed on an annual basis and following each review, the Customer may terminate the agreement at this point if it reasonably believes that the envisaged benefits are not being delivered or the Business Case is not being met. If the Customer exercises these termination rights it is required to make a compensation payments equivalent to any breakage costs that the Contractor may incur.

### 3.0 Service Supply

The Contractor will carry out the Deployment, Operational and Marketing Services to agreed specifications, plans, service levels, timescales and applicable standards.

There will be two elements of the performance mechanism with which the Contractor will have to comply; the services provided to the Customer under the Project Agreement and the services provided to Service Providers under the Access Agreements.

Failure to meet service levels will result in service credits, which will have a monetary value and be shown as a deduction from the monthly invoice.

Where continued failure leads to aggregated credits above an agreed threshold the Customer has the right to terminate the Project Agreement.

The Contractor will be obliged to monitor technological developments throughout the term of the Project Agreement and identify any resulting potential service improvements.

### 4.0 Access Agreements

The Contractor will be required to enter into Access Agreements with Service Providers and to comply with Open Network Principles.



Thales will collect Revenue from Service Providers under the Access Agreement on behalf of the Customer and will pass such revenue to Customer gross of any deductions Service Providers might make/claim.

A pro forma 'Access Agreement' has been agreed with Thales, based on similar agreements currently in the market. This will be used initially but will be reviewed with the Customer once a formal sales and marketing operation commences and the customer base is tested.

Upon termination or expiry of the contract, the Customer may, if it so wishes, elect to have all of the Access Agreements in existence novated to it or a replacement Contractor.

#### 5.0 Payments and Value for Money

The Contractor will receive payment on the completion and satisfactory testing of agreed milestones in the deployment stage (the "Pre-Operational Phase") and on the ongoing delivery of services in the Operational Phase. Payment will be by monthly invoice raised by the Contractor.

The amount to be paid in any month will be net of any deductions resulting from service credits awarded in the preceding period.

The majority of pre-operational and operational prices will be fixed in real terms at Contract Award and the risk on any movement in those costs will be carried by the Contractor. Element of costs which are for BT regulated products will not be fixed but will only change as those BT prices increase or decrease.

The Contractor is obliged to comply with Value For Money provisions, which require the Contractor to benchmark their operational services against similar network operators and reduce their charges if they are shown to be above the norm.

#### 6.0 Contract Governance

There will be agreed governance procedures, which will ensure the required visibility and control over the performance of the Contractor and its sub-contractors.

In order to oversee the operation of the Project Agreement, a structure consisting of a Management Board and Supervisory Board, on which Thales and the Customer will be equally represented, will be formed. In general the Customer will have a casting vote on each of these forums. There are a number of circumstances for which exceptions to the standard governance arrangements have been agreed.

Any changes to implementation, services, service levels etc. requested by either party after the commencement of the Project Agreement, will be subject to the Change Control procedure.

Any disputes arising during the term of the Project Agreement will be dealt with under the Dispute Resolution Procedure. This involves a process of escalation to the senior management of the Customer and Contractor, Mediation, Expert Determination and finally Arbitration.

#### 7.0 Personnel

The Contractor will be obliged to appoint the required level of staff with appropriate experience and expertise and to comply with agreed policies including Health and Safety and Equality & Diversity.

A number of Key Personnel will be appointed by agreement and the Contractor will be obliged to replace such personnel as quickly as possible with suitable replacements.

#### 8.0 Contractor and Customer Protections

The Contractor has general obligations to provide the services and to comply with all relevant consents, licences and permissions whether statutory, regulatory or contractual.

In turn The Customer is obliged to provide reasonable assistance to the Contractor and to respond to request for information within agreed timescales.

The Customer is required to use best endeavours to ensure it continues to receive the funding. Any delay or withdrawal of funding will become a Customer Cause (unless it is withdrawn because of a material default of the Contractor) and in the event of termination the Contractor will be compensated accordingly.

The Contractor will supply a Parent Company Guarantee in an agreed form. Thales has proposed that the guaranteeing body is not their ultimate parent, being the UK Holding company rather than the France registered parent. This is subject to negotiation but may be acceptable.

The Contractor and its Guarantor will be regularly monitored to ensure they remain financially robust. This will be done by reference to published credit ratings and financial ratios.

The costs arising from changes in law which are specific to the provision of the Services will be borne by the Customer all other changes in law will be borne by the Contractor. What constitutes a specific change in law is quite narrowly defined to include OFCOM mandated price increases and

changes to certain road traffic management, streetworks and health and safety legislation that mandate variances in the standards and working practices which the Contractor is required to follow in the provision of the Services.

#### 9.0 Risk Protection

The Contractor will be required to comply with agreed security requirements and method statements and produce and comply with a Business Continuity Plan.

Both parties will be relieved from their obligations in the event of a Force Majeure event.

#### 10.0 Indemnities, Liability and Insurance

The Contractor will indemnify the Customer from any liabilities arising out of third party intellectual property rights claims.

Under the terms of the Project Agreement, the Contractor has unlimited liability with respect to costs, claims, losses etc arising in relation to Tax Liability, the Employment (i.e. TUPE) Indemnity, Access Agreements and the IPR indemnity.

Subject to the exceptions outlined below, the amount the Customer can recover from the Contractor in relation to a default with respect to the Pre-operational Phase is capped at £30m. The exceptions being where the network fails to achieve a key milestone by the relevant "longstop date" up to and including the Final Acceptance test, in which case the liability cap increases to the greater of £30m and the payments made or due to the Contractor at the point of default. Therefore, if the network does not achieve final acceptance Thales liability will be capped at approx. £94 million being the payments due or made at the stage. If there is a network failure after the final acceptance then the Contractor's liability cap is calculated on a reducing balance from the full deployment costs down to the £30m by the end of year 10. The Contractor's liability for defaults during the Operational Phase which relate to the operational Services is capped, in each year, at the annual charges paid or payable for the Operational services.

The Contractor is required to take out insurance cover for agreed risks at minimum required levels of cover.

#### 11.0 Ownership of the Assets

The Customer will not take ownership of the network assets during the term of the Agreement but instead has an option to elect to take a transfer of the assets upon termination or expiry. The rationale for adopting this

approach is two-fold. Firstly, as a network owner and operator Thales will assume all liabilities associated with the management and operation of the network including regulatory responsibility. Secondly, the option to take ownership of the network assets means that the SPV can get the benefits of the capital allowances.

## 12.0 Terms, Termination and Exit Management

The term of the Project Agreement is for an initial period of 10 years from an agreed "go live" date (a point at which the network deployment is materially complete). The Customer has the option to extend the agreement for a period of up to 5 years on the same terms (" Extension Period").

Further network expansion beyond the initial term will be subject to a technology audit being carried out at year 7. If the audit demonstrates that any of the assets will not be economically viable beyond the initial 10 year term, then if the Customer elects to extend beyond the initial period it may pay for a technology refresh or if it does not will relieve the Contractor for any service failures if any of the identified equipment subsequently fails. During the Extension Period all other services will be provided at the same levels and at the same price where the Customer has elected to implement all the Contractor's proposals for technology refresh.

The Customer may terminate either all or part of the services early and may be liable to pay compensation to the Contractor in certain circumstances as follows:

### 12.1 Contractor Default (including Business Case Failure due to Thales breach of its marketing obligations) , Change of Control of the Contractor and continuing Force Majeure

If the Customer terminates in these circumstances no compensation payments are payable to the Contractor

### 12.2 Convenience and Customer Default

If the Customer terminates in these circumstances a compensation payment will be payable to the Contractor, which will consist of breakage costs reasonably incurred and up to 12 months loss of profit if sufficient notice is not given.

### 12.3 Withdrawal of Funding and Business Case Failure at Project Review Points

If the Customer terminates in these circumstances a termination payment will be payable to the Contractor, which will consist of breakage costs reasonably incurred

The extent of breakage costs payable is to be finalised but will include in general, the costs of making safe the network (if termination for convenience is made before the build of the network is completed), redundancy costs and the cost of terminating any sub-contracts. Thales will be obliged to mitigate such costs in all circumstances.

The Customer's right to partially terminate the Project Agreement is limited to the sales and marketing and billing and revenue collection functions. These services can be terminated on the grounds specified above so that if these services are persistently failing they can be terminated rather than the whole Project Agreement and the Customer can, if necessary, appoint an alternative provider appointed for those services.

As noted above on termination, either early or at expiry of the term, the Customer has the option to either take over ownership of the assets and operation of the Network or appoint a Replacement Contractor.

If the Customer: (a) terminates the Agreement for convenience or following a project review and (b) it does not elect to take a transfer of the network assets and termination occurs before the end of the agreed build, the Customer will be responsible for decommissioning costs, if termination occurs after the completion of the agreed build the decommissioning costs will be paid by Thales.

If the Customer elects not to take a transfer of the network assets it will not make or receive any residual payment for the value of the network assets unless Thales subsequently sells or otherwise disposes of the network asset for more than £10million, in which case the Customer will get 50% of the value above £10million.

On exit, the parties will comply with the Exit Plan, which will be developed and agreed after Contract Award.

The Customer has the right to step into the shoes of Thales if it is failing or if there is a Force Majeure or similar circumstance, and carry out the services itself. It may do so for a specified period after which it may step out and either allow Thales to resume the services or terminate all or part of the Project Agreement, as appropriate.

### 13.0 Assignment and Novation

The Contractor cannot assign or novate the Project Agreement without the prior written consent of the Customer.

The Customer may assign or novate its interest in the Project Agreement to any of the Authorities and any other third party who will carry out the functions of the Customer.

#### 14.0 Sales and Marketing

Thales will be responsible for the marketing of the network to the private sector in accordance with an agreed marketing plan. The SPV will be responsible for promoting the network and its capabilities across the wider Public Sector throughout the sub-region and will act as facilitator between the public Sector bodies, Thales and the Service Providers.

**Appendix B**  
**Detailed Overall Funding Spread**

£000

	2008/9	2009/10	2010/11	Total
<u>Funds Required</u>				
Deployment Costs	(17,668)	(41,346)	(33,977)	(92,991)
Operational Costs	(1,366)	(6,800)	(10,706)	(18,873)
<b>Total Funds Required</b>	<b>(19,034)</b>	<b>(48,146)</b>	<b>(44,683)</b>	<b>(111,863)</b>
<u>Funded By:</u>				
Net Trading Income Received		2,705	15,335	18,040
ERDF	19,034	10,788		29,822
Yorkshire Forward		14,000		14,000
YF Loan		12,392	17,608	30,000
LA Loans		4,130	5,870	10,000
Thales Loan		4,130	5,870	10,000
<b>Total Fund Sources</b>	<b>19,034</b>	<b>48,146</b>	<b>44,683</b>	<b>111,863</b>

The above detail is based on a 1<sup>st</sup> October 2008 commencement date.

## Appendix C : Risk Registers

### Public Sector Retained Risks - Pre Contract Commencement

Risk Heading	Detail/Rationale	Impact	Probability	Mitigation
<b>Project Financing</b>				
PWLB Interest rate increases prior to contract award	Interest on LA and YF loans will be fixed at contract award but movements up to that point will impact the business case	L	L	The current model is based on a prudent assumption which is above the current PWLB rates.
ERDF Grant not approved /terms not acceptable	The model is sensitive to the amount, timing and eligibility of ERDF funds. If the assumptions cannot be achieved then this could impact on the business case	H	L	The Commission has been closely involved in this project throughout and detailed consultation will continue to ensure the optimum outcome
YF Grant not approved /terms not acceptable	The model is sensitive to the amount, timing and eligibility of YF funds. If the assumptions cannot be achieved then this could impact on the business case	H	L	YF has been closely involved in this project throughout and detailed consultation will continue to ensure the optimum outcome
YF/LA Loan Funding not approved /terms not acceptable	The model is sensitive to the amount, timing and use of Loan funds. If the assumptions cannot be achieved then this could impact on the business case	H	L	LA approval secured from Members. Full engagement of all parties in Due Diligence process
<b>Price Movement</b>				
Delays in contract commencement lead to price uplift	Prices currently fixed until 1st January 2009. Any delay beyond that point is likely to lead to an uplift in contract costs	L	H	Ensure programme is managed as effectively as possible to speed up all necessary processes/approvals.
<b>SPV Creation</b>				
SPV Legal structure cannot be agreed	The contract can only be finally signed when the SPV structure is finalised and appropriate guarantees in place.	H	L	LA approval secured from Members. Full engagement of all parties in Due Diligence process
SPV appointments not completed in time	There are significant obligations of the SPV as soon as the contract commences with regard to control and approvals. If the necessary resource and expertise is not available then the project and the SPV are at risk.	M	M	Early commencement of appointment process at board and operational level.
<b>Taxation</b>				
Assumptions regarding treatment of assets results in higher Corporation Tax	Business case assumes that assets are on the SPV's Balance Sheet and are eligible for tax relief	L	L	Treatment will be agreed with HMRC prior to contract award. If the assumptions are not valid then gift aid to a charitable trust may be used to limit the tax charge.
Assumptions regarding VAT status of SPV results in un-recoverable VAT	Business case assumes that the SPV will have a business supply and can therefore recover input VAT	H	L	Treatment will be agreed with HMRC prior to contract award.



**Public Sector Retained Risks - Post Contract Commencement**

Risk Heading	Detail/Rationale	Impact	Probability	Mitigation
<b>Design and Construction</b>				
BT Openreach Costs higher than modelled	Assumptions as to number and extent of upgrades required to BT cabinets can only be verified post contract	M	M	Discussions have been ongoing and will continue with BT and OfCom to minimise pricing as much as possible
Indexation on build costs higher than modelled	A proportion of build costs are to be increased annually by the prevailing RPIX.	L	M	The modelled assumption is 3.5% p.a. which is felt to be prudent for the 3 year build period
Price increases on pass through elements higher than modelled	Elements of costs which are for BT regulated products will increase with any increases in those published prices	L	L	The modelled assumption is 3.5% which is felt to be prudent for the 3 year build period
Change in deployment leads to additional costs	The price is based on a set deployment across the sub region. Any changes requested by the SPV may lead to additional costs	L	L	Stakeholder expectations to be managed by Project Board
<b>Commission and Operating</b>				
Indexation on Operating costs higher than modelled	A proportion of operational costs are to be increased annually by the prevailing RPIX.	L	H	The modelled assumption is 2.5% p.a. which is felt to be prudent for the 10 year operational period
Price increases on pass through elements higher than modelled	Elements of costs which are for BT regulated products will increase with any increases in those published prices	L	L	The modelled assumption is 2.5% p.a. which is felt to be prudent for the 10 year operational period
Fibre rates higher than modelled	Assumptions as to the likely Hereditament charge will only be confirmed after the fibre length is confirmed	L	M	Work with Thales and the Valuation office to minimise the charge as much as possible
SPV Operating costs higher than modelled	The business case is based on a staff of around 15 people at an annual costs of £1.7m	L	H	Early and ongoing work to identify and review the resource requirements of the SPV
<b>Demand</b>				
Commercial take up delayed from model assumptions	The Business Case assumes user take up commences in month 9 of the deployment and steps up quite rapidly across the remainder of the build period. The funding of the network build is dependant on revenue generation in those early periods.	M	M	Continued engagement with Service Providers with the aim of obtaining commitment as to likely migration to the Network.
Penetration lower than modelled	The Business Case assumes penetration reaches 21% of the population by year 5 of the contract and remains flat thereafter. The funding of the network operation is dependant on revenue generation in those periods.	H	M	Continued engagement with Service Providers with the aim of obtaining commitment as to the likely user base and forward sales plans.
Wholesale revenue per user lower than modelled	The Business Case assumes users are taking multiple services across the network with an increasing mix of higher value services	H	M	Continued engagement with Service Providers with the aim of driving up use of the network and the delivery of next generation services.
Public sector revenue delayed	The Business Case assumes Public Sector (including L.A.) take up commences in month 15 of the deployment and steps up quite rapidly across the remainder of the build period. The funding of the network build is dependant on revenue generation in those early periods.	L	M	Continued engagement with appropriate LA officers and other Public Sector bodies with the aim of obtaining commitment as to likely migration to the Network.

Public sector revenue lower than modelled	The Business Case assumes Public Sector Revenue reaches £6m p.a. by year 4 of the contract and remains flat thereafter. The funding of the network operation is dependant on revenue generation in those periods.	M	M	Continued engagement with appropriate LA officers and other Public Sector bodies with the aim of driving up the use of the Network.
<b>Funding / Claw Back Risk</b>				
Outputs not achieved	ERDF funding is likely to be subject to the achievement of outputs. Failure to achieve those outputs within the timescales could result in claw back of some or all of the funding	H	L	Continued engagement with the EU to ensure outputs are acceptable and achievable before commitment to contract.
Expenditure ineligible	ERDF funding is likely to be subject to regulations in terms of what it can be used for. Failure to comply with those regulations could result in withholding of funds.	M	L	Continued engagement with the EU to ensure eligibility in line with business case assumptions before commitment to contract.
Drawdown period expired	ERDF funding may be subject to timescales in terms of when it has to be claimed. Failure to comply with those timescales could result in withdrawal of funds.	L	L	Continued engagement with the EU to ensure timescales are understood and are in line with business case assumptions before commitment to contract.
<b>Residual Value</b>				
Realisable value of assets created is less than modelled	The business case assumes that the value of assets created can be used to offset any financial exposure carried by the stakeholders but this is based on estimates which have not been validated.	M	M	Ongoing analysis of assets created and view of likely market interest in those assets.
Assets have a residual cost to de-commission and make good	If the assets are not consider to have a sale value then there could in certain circumstances be a cost to de-commission the network	M	L	Ongoing analysis of assets created and view of likely market interest in those assets. Contractual obligation for Thales to mitigate cost of decommissioning
ERDF or YF Grants secured against the assets	The business case assumes that the assets and any value realised from them will be fully available to the SPV shareholders in any circumstances. Any call on those assets by grant providers will increase the financial exposure of the Shareholders.	H	L	Continued engagement with the EU and YF to ensure the terms of the grants are understood and are in line with business case assumptions before commitment to contract.
<b>Technology/obsolescence</b>				
New technologies emerge making Digital Region less attractive	It is possible that new technologies may emerge (especially mobile and wireless access ) over the life of the contract which undermine the demand for the network.	H	L	The network is based on the next generation of fibre based technology and puts the region in a strong position to move to the FTTH which is recognised as the ultimate in fibre based broadband provision. Completely new technologies will take several years to develop as has been the case thus far. Mobile and wireless access is increasing and whilst it may not offer a complete alternative across the sub-region it could provide a degree of competition. The

				SPV will keep abreast of developments and will consider the impact in its forward planning.
<b>Regulation</b>				
Specific Changes In Law result in additional costs	Changes in law as defined by the contract may occur during the term of the contract incurring additional costs	L	M	SPV to keep abreast of OFCom mandated changes and analyse the impact on an ongoing basis. Impact of Traffic Management Act and other legislation affecting street works to be reviewed with LA's.
<b>Legal</b>				
Breach of the terms of the State Aid clearance	The European Commission granted the project state aid clearance based on a detailed submission setting out the objectives and terms of the project.	H	L	The project has and will continue to be reviewed against that submission to ensure that it is still compliant.

**Appendix D : DTZ Economic Impact Report**

See Separate Document

## Appendix E : Environmental Impact Analysis

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### **7 RECOMMENDATIONS**

This report has been written at the feasibility stages of planning for the Digital Region project. Considering that numerous details have not yet been determined nor conditions applied, Grontmij believe it timely to provide recommendations for ongoing actions for the project to ensure environmental best practice and legality.

#### **Environmental Management Plan**

The development of an Environmental Management Plan for Digital Region Project will provide a framework to outline the environmental needs of the project and clients. Such a plan enables the objectives (goals or policies to be achieved) and targets (performance requirements to enable objectives to be met) to be set. Through designating the responsibilities for certain actions to specific key staff in this way and by providing a timeframe by which the action should be completed will allow project progress.

The plan can be used throughout the project as a live working document and should be reviewed periodically to ensure progress against targets is being made. The topics to be included are numerous however some likely inclusions for Digital Region are listed below.

#### **Ecological Surveys**

Understanding the site specifics where works will be taking place and relationships with related designated areas (e.g. SAC SPA SSSI) is crucial as through legislation such as the Countryside Rights of Way 2000 Act and Conservation (Natural Habitats &c.) Regulations 1994 have conferred restrictions to certain areas and species thereby requiring additional planning and consultation prior to works. To reflect this it is recommended that site ecological surveys are undertaken, the success of which is highly dependent upon timings and as such surveys often span many months. By undertaking ecological investigation it is possible to avoid disturbance to protected species and habitat and also to prevent delays to the development schedule as it also allows time in order for licences to undertake works in such areas to be applied for and supplied. Protected species are safeguarded against capture, killing, injury or disturbance, with plants protected against collection, uprooting or destruction.

In addition to protected species, the SSSI SAC and SPA outlined earlier within the report other habitat and feature considerations include:

**Tree Protection Orders** - In addition to individual species there may be interaction with trees with Tree Protection Orders requiring fencing off of areas in line with BS5837:2005 to ensure sufficient protection is conferred to avoid damage to trees or their roots.

**Hedgerows** - Covered under Hedgerow Regulations 1997 most hedgerows over 20m in length and / or form part of a longer stretch of hedgerows are protected and need a Removal Notice in order to achieve this.

Phase 1 habitat surveys by qualified, licensed and experienced surveyors provide broad analysis of the types of habitat present along with an indication of the associated potential species present. Indications from Phase 1 will prompt a more detailed Phase 2 survey to highlight the presence of specific groups of plants and animals thereby identifying protected species. In the event that protected species are present, such surveys provide developers with scope to ensure species and

habitat are not harmed. It is likely that (but not restricted to) the following species may be encountered during the Digital Region works:

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Nesting Birds - Wild birds are protected during nesting season potentially impacting installation if nests are found in the area of works, all activities will have to cease until breeding has ceased with nests to be inspected by a trained ecologist.

Badger Setts - Nearby setts will impact site traffic routes for tracked and light machinery with only hand digging and clearance allowed within 10m. Any sett destruction must be approved and overseen by a licensed professional to close the sett and encourage badgers to relocate to other setts nearby.

Bats - Potential for bat roost in trees near to installation is problematic as even damage to a potential roost without bats present is illegal. Therefore licensed bat workers should be approached to investigate options for the scheme.

Great Crested Newts (GCNs) - Presence of GCN will require exclusion from working areas by newt netting, trapping and translocation to ensure the area is clear for works to continue avoiding detriment to the species. For example the identification of a high density of ponds with interconnected vegetation may hold potential for great crested newts.

Water Voles - Works near canals and other watercourses have potential for interaction with water voles.

#### Pollution Prevention

Although there are minimal pollution impacts associated with the project it is important to ensure pollution potential is managed appropriately.

Enforcing Authorities - Site visits should be arranged with local Environment Agency and Environmental Health officers prior to starting on site to avoid any serious problems from arising and to obtain best practice guidance for activities within the region.

Watercourse Quality - Proximity of works to watercourses should be mapped to ensure no reduction in water quality through contamination of run off from excavated areas. Works should be conducted in line with Environment Agency Guidance PPG 5 Working In, Near, of Liable to Affect Watercourses. Where necessary water sampling should take place if included in planning conditions or if recommended by the EA.

#### Ground Investigation Survey

As discussed with preferred contractors, 25 % of materials excavated from new cable runs will be discarded as waste. As at the time of writing a ground investigation survey was not available it must be considered that contaminated land may be present in areas of the installation. It is necessary for such waste to undergo WAC (Waste Acceptance Criteria) testing to determine its classification within the hazardous hierarchy. In the event of the waste being considered Hazardous, registration with the Environment Agency is required to obtain a Hazardous Waste Carriers Certificate.

#### Site Waste Management Plan

It is the responsibility of the client to produce the initial Site Waste Management Plan prior to any works being undertaken. This enables all members of supply chain, design and operation to contribute towards reduce, re-using and recycling site produced waste.

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The plan is to contain:

- The types of waste removed from the site
- The person removing waste from site, their waste carrier registration number, and a description of the waste
- The site the waste was taken to
- An environmental permit or exemption held by the site where the material is taken.

It is then the responsibility of the client to pass on the plan to the principal contractor with review every 3 months if project managing is not sub contracted. At the end of the project, the Site Waste Management Plan should be reviewed against targets and the explanations for disparities between plan and actuality recorded.

Statutory Nuisance

Development projects can be subject to potential dust and noise issues which arise when the source of production is close to a receptor such as local residents. With this in mind cable installation will take place in a manner to avoid dust and noise generation.

Dust will be controlled through a process of dampening down regularly using a fine mist of water and by following available Best Practice guidance such as 'CIRIA Compliance+ Emissions to Air'.

Complaints and damage as a result of excessive noise can be prevented through using noise controls on machinery where possible, implementing screens if appropriate and ensuring plant is correctly maintained. This will be led and reinforced through use of available Best Practice guidance such as 'CIRIA Compliance+ Noise'.











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