

Vote 32 - Public Enterprise

29. International Telecommunications Connectivity

Background

In July 1999, the State, represented by the Department of Public Enterprise (the Department) and IDA Ireland, entered into a 25 year contract with Global Crossing Ireland Ltd. (Global Crossing) for the provision of large capacity bandwidth with global connectivity. The availability of such high capacity bandwidth at competitive rates was one of the recommendations of the Advisory Committee on Communications, which had been established by the Minister for Public Enterprise to advise on a strategy to position Ireland as a key global centre in advanced telecommunications, the Internet and electronic commerce.

Following a call for proposals to suppliers and a subsequent negotiated process, Global Crossing was selected as connectivity supplier on the recommendation of an Inter-Departmental/Agency Task Force, led by the Department and advised by a multi-disciplinary team of consultants. The contract with Global Crossing provided for the connecting of Ireland to European and American networks through two submarine telecommunications cables landed in Wexford and terminating at an international high-speed bandwidth exchange (telehouse) at CityWest Digital Park in Dublin.

The capacity acquired, 160 STM-1s¹⁷, costing £60,752,875, represented a fifteen fold increase in existing levels of international capacity out of Ireland. It was considered that this new level would greatly enhance Ireland's position as a preferred location for new digital industries serving the European electronic commerce market of over 300 million consumers. The contract also provided options for the State to purchase further capacity.

The Government Decision approving the project, provided, in principle, for the State to transfer to third parties its rights and obligations under the agreement with Global Crossing on an investment-recoupment basis. The Department invited bids from telecommunications operators to ensure compliance with the policy that the increased capacity should be made available to the Irish market at a competitive rate. As a result of this process, contracts were agreed with 6 companies for the sale of 154 STM-1s. Payment was to be made in stages up to December 2002.

The Government also agreed that a proportion of the available bandwidth could be made available for public interest and strategic initiatives in areas such as education and research. One proposal was for the transfer of 7 units of capacity and options on a further 9 units to HEAnet¹⁸ to facilitate the upgrading of the national broadband research network.

Objectives and Scope of Audit

The objectives of the audit were to assess:

- The systems and procedures in operation for the managing and monitoring of the interconnectivity project
- Total costs and revenues, both actual and projected, and to consider the State's exposure on the project

¹⁷ STM (Synchronous Transport Module). STM-1 is a unit of capacity equivalent to the transfer of data at 155 Megabits per second.

¹⁸ The network operated by the Higher Education Authority.

- Whether contracts entered into were adequate to protect the State's interest
- The procedures adopted in the selection of the interconnectivity supplier and the telehouse provider
- The procedures employed for the onward sale of capacity to telecommunications operators
- What action has been taken in relation to options acquired by the State for the purchase of further capacity

The procedures adopted in the management of the project were reviewed. The Department's files relating to the selection of a connectivity supplier, the sell-on of capacity to telecommunications operators and the appointment of professional advisers were reviewed. Minutes of Task Force and Steering Group meetings, correspondence with other Government Departments and Agencies, Government Decisions and Memoranda, and legal agreements were also examined.

Audit Findings

Management and Administration of Project

The Department has primary responsibility for the project. Following the publication of the Report of the Advisory Committee on Communications, it established and led an inter-Departmental/Agency Task Force representative of the Department of Enterprise, Trade and Employment, the Department of Finance, IDA Ireland and Forfás. The Task Force met regularly and proceedings and decisions were recorded. It appointed a team of professional advisers to assist in the project assessment and to negotiate with interested connectivity suppliers. The Task Force and its advisers selected the connectivity supplier. Completion of a contract with Global Crossing was recommended to Government in June 1999. The necessary funding was channelled through the Vote for Enterprise, Trade and Employment and IDA Ireland. The Task Force also oversaw the process leading to the sale of capacity by the State to telecommunications operators. IDA Ireland is responsible for making payments under the supply contract to Global Crossing and for the collection of revenues due in respect of the onward sale of capacity. These transactions, together with the asset acquired by the State, are accounted for in the financial statements of IDA Ireland.

Selection of Connectivity Supplier

Based on the advice received from its consultants, the Task Force issued a call for supply proposals in early 1999. Thirteen suppliers pre-qualified and were invited to submit detailed commercial bids. Four suppliers submitted bids which were evaluated. The Department then entered negotiations with two companies. Global Crossing made a signed final offer in mid-June 1999 and this was recommended for acceptance. Key factors in the selection were cost and the short timescale within which completion was guaranteed. The ready for commercial supply (RFCS) date outlined in the agreement was 30 June 2000. Because of some difficulty in finalising and testing the system, however, it did not go fully live until 26 August 2000. The Department indicated that unit costs negotiated were between 10% and 15% of existing market rates, depending on the route in question.

At about the time of the approval of the Global Crossing contract, another company announced plans to link Ireland, the United Kingdom, Canada and the United States by transatlantic cable. This company opted not to submit a formal tender in respect of the project under review as it wished to have commercial freedom to operate in the Irish market. Details of the cost, funding and timescale envisaged were unclear. The Department considered that the two projects were not mutually exclusive but that the terms of the Global Crossing proposal were known, manageable and best suited to the objectives of the initiative. The Government was aware of this alternative project in making its decision.

Contractual Arrangements with Supplier

Key elements of the proposed contract with Global Crossing formed part of the Memorandum considered by Government at its meeting of 22 June 1999. The agreement covers the provision by Global Crossing of seamless access to a high capacity telecommunications network spanning Ireland, 24 European cities and New York. Two submarine cables linking Ireland and Great Britain were constructed and the network was completed in August 2000. The cost of the contract was £60,752,875, payable on a phased basis to the end of 2002. At 31 July 2001, £42,412,383 had been paid.

The Department has since re-negotiated elements of the contract which has resulted in a number of enhancements at no extra cost. It now covers connectivity to 40 European cities, 7 in the US and 2 in Asia. Operation and maintenance charges have also been significantly reduced.

In addition, the State acquired an open-ended option to purchase a further 80 STM-1s and an option to purchase or lease the use of a number of “dark fibre” pairs on each of the submarine cables. The Department considers “dark fibre” to be extremely valuable due to the high speeds at which it can transmit large amounts of data.

Sale of capacity

Eight of the larger telecommunications companies were invited, at a cost of £50,000 each, to pre-qualify as bidders for capacity on the inter-connector. The Department also circulated a bid package outlining sale terms to another 67 companies. Initially the offer was over-subscribed. Bids were received for 179 STM-1s, but this was reduced to 154 STM-1s through the withdrawal of 2 bids. The Department fixed the unit sale price on an investment-recoupment basis.

Contracts to a total value of £63,622,668 were agreed with six companies for the 154 STM-1s. However, there have been difficulties in relation to three of the companies with the result that, at the end of July 2001, contracts were only active in respect of 73 STM-1s to a value of £30,270,354.

In relation to the unallocated capacity arising from the difficulties, the Department informed me that it is currently in negotiation with a number of companies who had previously sought to acquire capacity.

In regard to HEAnet, 5 STM-1s have been transferred, 2 STM-1s have been reserved and an option has been granted on the use of a further 9 STM-1s.

Payments under the sale of capacity contracts were to be made in instalments in accordance with an agreed schedule of payments. At the end of July 2001, £8,898,193 had been received on foot of these contracts but the December 2000 and April 2001 instalments to a total value of £7,764,036 are overdue.

Telehousing

Under the terms of the contract with Global Crossing, the Government Agent was obliged to provide the physical location for the two points of interconnection to the Global Crossing network in Ireland. The Department advertised a competition, under which the successful bidder would take on the commercial risk of building and fitting out a world-class telehouse facility in return for being designated as the first connection point. Government funding was not to be made available in respect of the contract. The Department and IDA Ireland are currently in discussion with Global Crossing regarding the second point of interconnection.

Eleven companies responded to the advertisement and a short list of four was drawn up. Detailed negotiations were entered into with TeleCity and another company. One of the deciding issues in awarding the contract to TeleCity was their ability to meet the deadline of June 2000. The contract was signed in Spring 2000. It stipulated that TeleCity make available 2000 square feet to Global Crossing to locate their bandwidth manager and electronic equipment.

The telehouse, located at CityWest Digital Park and with an area of 60,000 square feet, was completed on time. Differences between the landlords of the digital park and the telecommunications companies over access pricing on the local ducting delayed full implementation until they were resolved in March 2001.

Appointment of Professional Advisers

Following the issue of a notice in the Official Journal of the European Communities by the Department, a multi-disciplinary team of advisers and consultants was appointed. None of the original tenders received constituted the full set of skills and expertise required by the Task Force to implement the project. Contracts were awarded by way of negotiated procedure to entities that were deemed to have presented the most economically advantageous tenders in the fields of technical, legal, regulatory, project management, financial and market expertise.

The Department received sanction from the Department of Finance and the Government Contracts Committee to cover contracts valued at £632,337. However, costs incurred totalled £1,230,271, as a result of overruns on project management and legal services. The Department contend that it made every effort to maintain costs at a reasonable level and cite unforeseen circumstances such as amendments to the original contract with Global Crossing and the conclusion of further contracts in relation to maintenance and operation of dark fibre, access to and co-location at 4 cable stations, a telehouse agreement and a re-sale process. In that context, the Department maintain that, in a very specialised market, it was prudent to retain the advisers to ensure there was no loss of continuity and expertise. The Department of Finance, in giving retrospective sanction, pointed out that an overrun of this magnitude was unacceptable.

The costs of services provided from 1998 to 2001 are shown in Table 35.

Table 35 Costs of Services 1998-2001

	£
Legal	542,523
Project Management	466,000
Market Intelligence and Analysis	106,055
Financial	71,057
Technical	28,984
Other	15,652
Total	1,230,271

Conclusions

The project was recommended to and approved by Government on the basis that it was essential to increase, as a matter of urgency, the bandwidth available for international telecommunications between Ireland and the rest of the world. While projects of this kind have long time horizons and are difficult to assess in the short term, the following early observations can be made:

- The primary objective of providing large capacity bandwidth with low cost connectivity was achieved.
- Structures put in place were adequate to enable the project to be monitored by the Task Force in a

satisfactory manner.

- The choice of Global Crossing as connectivity supplier and TeleCity as telehouse provider were made after fair and thorough selection processes.
- While the arrangements for obtaining the supply of bandwidth were satisfactory, the contractual arrangements as implemented for on-selling the capacity were less successful.
- Specific performance of contractual obligations on the purchasers of capacity, particularly in regard to bonding and guarantees, should have been required.
- Outstanding instalments from purchasers should be vigorously pursued.
- The delay in resolving the access pricing issue resulted in the purchasers not drawing down STM-1s and consequently may have been a factor in the lack of timeliness of payments due from the purchasers under the contracts.
- Any reduction in the demand by telecommunications operators for services provided or further difficulties in the execution of contracts would have serious adverse implications for the State recouping its £60m investment.
- While the Department's explanation for the overrun on the costs of advisers is accepted, the necessity for such an increase in the level of project management and legal services should have been anticipated.

Observations of the Department of Public Enterprise

- The project has a 25 year life span and its economic and commercial value to the country must be viewed over that time-scale
- The relative success of the project and the difficulties of late in recouping investment from the market should be viewed against the backdrop of the very considerable downturn in the technology and telecommunications markets globally. The scale and depth of the downturn could not have been foreseen at the time of contract conclusion.
- The project was managed very tightly from start to finish. The contracts were negotiated in an extremely narrow window of opportunity and the project went live within 14 months of those contracts being signed.
- The project has been instrumental in attracting and retaining a number of prestigious international investment opportunities in Ireland.
- The access pricing issue at City West Digital Park was outside the control of the Department and the Steering Committee.
- The Department will shortly undertake a value for money review of the project to date.