
Decision maker:	Cabinet member: Corporate Strategy & Finance
Decision date:	18 June 2015
Scrutiny committee call-in date:	23 June 2015
Date decision may be implemented:	24 June 2015
Title of report:	Realising the commercial potential of the Enterprise Zone's broadband network
Report by:	Enterprise Zone Managing Director

Classification

Open

Key Decision

This is not a key decision

Wards Affected

Dinedor Hill

Purpose

To seek Cabinet Member approval for a proposed Joint venture to develop ultrafast broadband services for the Hereford Enterprise Zone.

Recommendations

THAT the Cabinet Member agrees:

- (a) To the principle of development of a joint venture opportunity (option 1 below) to deliver broadband services for Hereford enterprise zone and Rotherwas industrial estate under the market economy investor principle;**
- (b) that a suitable preferred joint venture partner should be identified using established council processes. The choice of partner to be signed off by the Director of Economy, Communities and Corporate;**
- (c) that an initial business plan should be developed with the preferred joint**

venture partner to meet the requirements of the market economy investor principle, and

- (d) that the negotiated deal including that plan be brought back to the Cabinet Member for consideration and approval.

Alternative options

The preferred option, Option 1, is a full joint venture.

1 Option 1 - Full joint venture option

The council (on behalf of the EZ) would enter into a full joint venture (with no fixed duration) with a communications provider to establish a wholesale service portfolio for the site. The council/EZ would undertake a market engagement exercise to identify an appropriate partner to undertake a joint venture approach.

Advantages

The joint venture approach allows the public sector to work with a suitable service provider to share risks and resources as necessary to make the provision of services viable. It is expected the EZ/council would be able to contribute the existing duct infrastructure (to date) as its equity contribution to the joint venture, with the partner contributing appropriately to ensure the commercial viability of the undertaking. Undertaken using the “market economy investor principle” (MEIP), this approach is not state aid. The full joint venture option has the advantage of providing the best opportunity to deliver ultrafast broadband services to the site pro-actively, and to gain an optimum commercial benefit without requiring state aid notification.

Disadvantages

It has the disadvantage of requiring careful commercial planning and negotiation to ensure best value to the council/EZ.

2 Option 2 - Do nothing

Advantages

No further investment would be needed.

Disadvantages

Open access duct infrastructure for the enterprise zone (EZ) has been installed to support the provision of fibre based broadband services. This infrastructure is part constructed and needs to be commercialised. If no further action is taken, the infrastructure may remain unused or may be only partly used by service providers, but no commercial benefit will be gained by the council other than basic fibre tax. It is also unlikely that it will lead to widespread availability of fibre based ultrafast broadband services. The duct infrastructure will also not be extended to serve the remaining areas of the Rotherwas industrial estate which are not part of the EZ. Doing nothing will result in uncertain utilisation of the existing investment in duct infrastructure, and potentially poor availability of fibre based ultrafast broadband services for the EZ.

3 Option 3 – Basic infrastructure provider option

The council (on behalf of the EZ) would offer free access to the duct infrastructure directly to communications providers.

Advantages

Conceptually, this is relatively simple. However, there would be some necessary management of the infrastructure and its use. This would require a dedicated expert capability to be established for the management and maintenance of the duct infrastructure, and management of the whole relationship with communication service providers. It would also be important to ensure access is provided at “market rates” – though it is not clear what “market rates” are since there is no established and active market for these infrastructure services in the UK. The “basic infrastructure provider option” has the advantage of strong commercial control over the use of the infrastructure.

Disadvantages

This option would require a dedicated expert capability to be established at a cost to the EZ (council). It would also require additional investment to complete the full infrastructure network, and an ongoing financial commitment to manage its use.

4 Option 4 - Concession option

The council (on behalf of the EZ) would offer a concession to service providers to use the passive infrastructure to deliver wholesale services on a commercial basis.

Advantages

This is a relatively established principle for the delivery of Wi-Fi services in busy urban areas – where access to “street furniture” is offered on a concession basis. The “concession option” has the advantage of providing an opportunity to deliver ultrafast broadband services to the site, and to gain a commercial benefit.

Disadvantages

There are no known cases of concessions for the use of duct infrastructure. Although concessions for the use of existing infrastructure are not considered state aid, recent guidance suggests that the construction of infrastructure specifically to be used in a concession model may represent state aid. As with the basic infrastructure provider option, it would be necessary for the EZ or council to complete the construction of the duct infrastructure to ensure complete coverage of ultrafast broadband services. It has the disadvantage of requiring investment to complete the infrastructure construction, and an unclear state aid position (which realistically requires notification to avoid challenge).

5 Option 5 - Joint venture concession option

The council (on behalf of the EZ) could offer a limited period concession to a service provider to use the passive infrastructure to deliver wholesale communications services, and enter into a joint venture with the chosen concession holder.

Advantages

The joint venture approach allows the public sector to work with a suitable service provider to share risks and resources as necessary to make the provision of services viable. Through the concession style approach, it is expected that the EZ/council would be able to contribute the existing duct infrastructure as its equity contribution to the joint venture, with the partner contributing appropriately to ensure the commercial viability of the undertaking. Undertaken using the MEIP ensures this approach is not state aid. The joint venture concession option has the advantage of providing an opportunity to deliver ultrafast broadband services to the site, and to gain a commercial benefit without requiring state aid notification.

Disadvantages

This approach has the disadvantage of requiring careful commercial planning, and investment to complete the infrastructure construction. The limited period of the concession based approach may well also restrict the commercial attractiveness of the approach compared to a full joint venture option.

Reasons for recommendations

- 6 EZ status provides a huge opportunity to fast track the build out of 170 acres of development land, creating 4,000 job opportunities over the 25 year lifetime of the zone. Access to good broadband is seen by Government as a major policy priority in establishing the zones. This is even more important in Hereford, where to exploit the zone's full potential we need to address comparative locational disadvantages particularly in accessing physical transport infrastructure such as the motorway network. Having 'best in class' broadband capability gives the zone first mover advantage as a business park and a competitive edge in attracting communication focussed and data hungry businesses. Without taking action, only BT FTTC (fibre to the cabinets) and leased line services will be available. These do not allow the site to be competitive against other areas, particularly with the increasing scope of the Super Connected City programme.
- 7 Different commercial and operational models have been considered. The full joint venture approach under the MEIP allows for the development of appropriate broadband services, and commercial benefit from the investment in the duct infrastructure, without the requirement for a state aid notification – which could potentially add significant delays.
- 8 To undertake a joint venture development to deliver ultrafast broadband services requires an appropriate partner (or partners) to provide the necessary investment and technical capabilities. A respected company in the sector has approached the EZ with a view to undertaking a joint venture to commercialise the investment in duct infrastructure on the site having become aware of that investment. Their interest suggests that the approach is commercially viable.
- 9 The company in question has provided an outline proposal for a joint venture development. However, it is believed that the initial proposal may have scope for an improved commercial outcome for the council. Interest in undertaking some form of joint venture commercial arrangement has also been expressed by another local company – who already have a high bandwidth (1 Gbps) backhaul fibre connection to the site. Further activity to identify and select the most appropriate joint venture partner is considered necessary and appropriate to seek to ensure the best deal.
- 10 There is a need to provide a detailed commercial analysis to meet the requirements of the MEIP development. Detailed negotiations with the identified joint venture partner will allow the full commercial scope for the council to be determined, and develop the detailed commercial analysis required to demonstrate that no state aid is involved.
- 11 A robust business plan is required as a condition of the use of the MEIP. The business plan must demonstrate a reasonable expectation of an appropriate return on investment – a condition of proving that no advantage is conferred, and as such the investment is not state aid.
- 12 A potential deal would see the most expensive component of the duct infrastructure outstanding installed by the private sector partner, and an annual financial return to the council (EZ) by that partner. Entry into a deal would ensure that the private sector partner would look to maximise uptime and usage of the network to the benefit of the several hundred businesses on the Estate and on the Zone.

Key considerations

- 13 The basic broadband services previously available on the Rotherwas Industrial Estate were entirely inadequate for business use. ADSL services served over very long lines resulted in very low bandwidth and unreliable service. Until recently, the only alternatives were leased lines or wireless broadband services. Leased Lines are prohibitively expensive for most business users. The wireless broadband services were not found acceptable by many businesses on the site.
- 14 Thanks to the efforts of the Fastershire programme, couple with the priority assigned to EZ's generally, FTTC superfast broadband is now available on the site. Four BT cabinets serve the Rotherwas industrial estate and EZ site. FTTC services on the site can expect to provide 30Mbps download and 5Mbps upload bandwidths. Although superfast broadband represents a significant improvement on the existing broadband services, it does not provide a competitive data service in comparison with other locations in the Super Connected Cities programme – where ultrafast broadband services will be made available.
- 15 The provision of an open access duct infrastructure was identified as a means of enabling the availability of fibre based ultrafast broadband services on the site. An appropriate duct infrastructure has been planned in four phases to cover proposed business occupation on the enterprise zone and Rotherwas industrial estate. The first and second phases are complete. Installation has cost circa £300,000 and has been done cost effectively by utilising soft dig and preparation for other utility investment on the site. The third phase is ready to be installed. The fourth, to open out the existing estate has been planned, but is not a component that the enterprise zone can readily invest in as it only helps the existing Estate. This phase would be subject to the conclusion of the negotiations and will cost circa £175,000. See Appendix.
- 16 The development of duct infrastructure is supported by the European Commission as a particularly effective means of promoting broadband availability. State aid guidance prepared for the European Commission identifies “Whenever such civil engineering works are carried out in your area (e.g. for purposes of gas, water or electrical provision) you should take the opportunity to coordinate such activities and deploy ducts.”
- 17 Although the provision of duct infrastructure is encouraged, recent guidance suggests that its development and use can still be considered state aid. The development of the UK umbrella scheme has greatly simplified state aid notification for broadband in the UK, but state aid approval for schemes outside of the normal BDUK programme delivery may still impose delays.
- 18 Entering into a Joint venture and using in-kind capital investments rather than direct capital funding does not necessarily avoid state aid. However the “market economy investor principle” (MEIP) operates by placing capital directly or indirectly at the disposal of an undertaking *under normal market conditions*. Critically the capital funding is made as an investment, with the expectation of economic return. As such, it does not confer advantage, so is not state aid. To use the market economy investor principle, it is essential to provide a robust business case for the undertaking, demonstrating a reasonable expectation of appropriate return on investment in *advance* of investing in the undertaking (joint venture).
- 19 Although the provision of an open access duct infrastructure was identified as critical in the deployment of fibre based broadband services, other elements are required. There is a need for communications provider(s) to take the commercial risk to bring a suitable backhaul connection to the site. An active (fibre) network needs to be deployed within the passive (duct) infrastructure. The passive and active infrastructure requires ongoing operation, maintenance and support. A wholesale

provider typically provides these services so that retail communication providers can then deliver final services to end users. Communication providers may deploy elements of active infrastructure themselves, or simply re-sell wholesale products.

- 20 A number of different potential wholesale service providers could become appropriate Joint venture partners, including BT, Virgin Media, Airband, Gigaclear, Broadway Partners, Hyperoptic, ITS Technology Group and WarwickNet.
- 21 An outline proposal has already been presented by a broadband provider. The proposal provides a high level review of their operation and possible Joint venture approach. The proposal shows a positive approach to the development of a Joint venture undertaking, and track record of delivering appropriate services.
- 22 To ensure the most beneficial way forward for the Enterprise Zone, it is proposed that a formal process of market engagement should be undertaken identify potential joint venture partners, select the most appropriate partner, and negotiate the most beneficial terms for the Joint venture agreement. This would include the company mentioned above. The formal process will be taken forward utilising legal and procurement support and advice through a project steering group to ensure that it complies with Council arrangements.

Community impact

- 23 The proposal supports the development of the Hereford Enterprise Zone, and the national Enterprise Zone strategy. Specific research commissioned by the EZ confirmed the need for improved broadband services on Rotherwas to meet business needs.
- 24 The development of the Enterprise Zone, with consequent expansion of the local business base, increase in job opportunities and the potential for increased wealth and prosperity has been welcomed by the local community represented on the Enterprise Zone Stakeholder Group.

Equality duty

- 25 Section 149 of the Equality Act 2010 imposed a duty on the Local authority to have due regard to the need to;
 - a. Eliminate discrimination,
 - b. Advance equality of opportunity
 - c. Foster good relations
- 26 The development of the Enterprise Zone will support the council's commitment to Equality by advancing equality of opportunity, with the potential of increased job opportunities.
- 27 The joint venture undertaking and all participating partners will be required to support the public sector equality duty.

Financial implications

- 28 The initial proposal is to undertake discussions with one or more potential partners with a view to entering into a Joint venture undertaking. This initial undertaking has limited financial implications, and a revenue budget exists for these costs. Specialist sector advice has been procured by the Enterprise Zone to support the negotiations but further financial implications would be dependent upon the satisfactory conclusion of these negotiations.

- 29 If successful negotiations can be concluded, then there will be likely financial implications. These will be included in a further report, once options for a way forward have been identified.
- 30 The investment to complete phase 3 of the duct infrastructure at an estimated cost of £118,000, has already been approved as part of the Enterprise Zone's capital budget for this year, and will proceed independent of the joint venture discussions. The fourth phase has been costed out at £175,000 and would be subject to negotiation, with a view to the private sector partner picking up that investment as part of the joint venture.
- 31 An estimate has not yet been established for the financial commitment to the operation of the joint venture. This approach also provides the prospect of the council (Enterprise Zone) receiving a return for use of the prior investment on duct infrastructure. It will be open to the council to decide how it utilises this potential, regular receipt – it could use it to net off the contribution that it makes to the Zone costs.

Legal implications

- 32 The council will need to consider (with assistance of legal services) the procedure it wishes to follow to select a joint venture partner. Whilst a full tender is unlikely to be necessary, any procedure will still need to follow usual principles of fairness, transparency, equal treatment etc., and will need to give the council the best possible chance of identifying the best candidate. The council will also need to consider (with the assistance of legal services) the appropriate joint venture vehicle, and the terms of the 'deal' which the council initially offers the market and which it ultimately accepts with the preferred bidder.
- 33 The council ought to be aware that joint venture arrangements of this kind are inherently complex. Concluding a joint venture agreement is unlikely to be a simple process.
- 34 The proposal is to work with legal services to undertake discussions with a view to entering into a Joint venture undertaking. This initial development will have no legal implications until a suitable Joint venture approach has been agreed with Legal Services.

Risk management

- 35 The aim of developing the open access duct infrastructure is to provide an efficient means of promoting the availability of a range of high bandwidth broadband services to support the competitiveness of the Enterprise Zone. Key risks now are:
- d. That the open access duct infrastructure is not completed to the point where fibre based broadband services are provided through it;
 - e. That state aid or other issues impose significant delays on the delivery of broadband services;
 - f. That a joint venture undertaking will favour the private sector partner, and not provide an appropriate return on investment or economic return for the council and Enterprise Zone; and
 - g. That a state aid challenge imposes delays, or identifies that state aid conditions have been breached.
- 36 If no action is taken, then it is likely that little use will be made of the existing

constructed duct infrastructure and the required broadband services will not be made available. This would impact the competitiveness of the Enterprise Zone and Rotherwas industrial estate. Action is proposed to commercialise the duct infrastructure and ensure the provision of appropriate broadband services.

- 37 The use of the market economy investor principle through a joint venture undertaking is proposed to avoid delays and restrictions due to state aid.
- 38 It is proposed that the council and Enterprise Zone completes phases 1, 2 and 3 of the duct infrastructure as its in-kind capital investment in the joint venture. This will help ensure the completion of the duct infrastructure and help ensure the availability of appropriate broadband services to support the development of the Enterprise Zone.
- 39 Detailed and robust negotiations are proposed to ensure an appropriate Joint venture agreement. This will ensure an appropriate return on investment and effective economic return for the council and Enterprise Zone.
- 40 The detailed negotiations will be based around the development of a robust business case for the joint venture. This will help shape the negotiations, and meet the requirements of the market economy investor principle development.

Consultees

- 41 The recommendations have been developed following previous consultations with businesses located on the Rotherwas industrial estate and requests from potential investors on the Zone. These consultations identified the pressing need for improved broadband on the site.
- 42 Preliminary discussions have taken place with key contacts from the finance, procurement and legal teams to help shape the approach.

Appendices

Plan showing the broadband network

Background papers

None identified.