



REPORT OF THE AUDITOR GENERAL

To the House of Assembly



On a Review of the "Fibre Optic Deal"

Auditor General of Newfoundland and Labrador

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Mission Statement

The Office of the Auditor General serves the House of Assembly by providing independent examinations of Government and its entities.

As legislative auditors, we audit financial statements and other accountability documents, evaluate management practices and control systems, and determine compliance with legislative and other authorities.

Our purpose is to promote accountability and encourage positive change in the stewardship, management and use of public resources.



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17 September 2007

The Honourable Harvey Hodder, M.H.A.
Speaker
House of Assembly

Dear Sir:

In compliance with section 16 of the *Auditor General Act*, I have the honour to submit herewith, for transmission to the House of Assembly, my Report on a Review of the "Fibre Optic Deal".

Respectfully submitted,

A handwritten signature in black ink, appearing to read "John L. Noseworthy".

JOHN L. NOSEWORTHY, CA
Auditor General

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Reflections of the Auditor General



On 2 November 2006, Government announced it would “...invest \$15 million, over the next two fiscal years on the installation of a fully redundant fibre optic link which will run from St. John's to Halifax along two diverse routes to connect the national carriers into mainland Canada.” On 22 November, the House of Assembly passed a resolution asking me to “...investigate all the details and circumstances of the fibre optic deal [the Project].”

The review was unlike most conducted by my Office in that, when it commenced in December 2006, there was no final contract in place, negotiations with Persona Communications Corp. (Persona) were ongoing, and no money had been advanced. The final Agreement with Persona committing Government to the \$15 million purchase was not signed until 18 July 2007 and the first disbursement of \$5 million was not made until August 2007, some 8 months after we started our review. Therefore, we were effectively reviewing a moving target until July 2007.

I prepared a scope document and, on 22 February 2007, met with the Government House Leader, the Opposition House Leader and the Leader of the New Democratic Party, to discuss expectations of the Members of the House of Assembly. The objectives of the review were to determine whether the Premier was involved in the Project, whether Government complied with legislation and other authorities, whether Government's commitment was based on a comprehensive review, whether Government will receive value for its planned investment and whether there were any other matters of significance.

We found the following:

- **Whether the Premier was Involved in the Project**

The review of documentation, including unprecedented and unrestricted access to Cabinet documents, as well as formal interviews with officials, disclosed no evidence that the Premier was involved in the Project.

In addition, on 21 December 2006, the Premier provided my Office with an affidavit indicating that he did not participate in the Cabinet decision of 26 October 2006 which gave approval in principle for Government to participate in the Project with Persona.

- **Whether Government Complied With Legislation and Other Authorities**

The Department of Innovation, Trade and Rural Development did not comply with the Guidelines for the Hiring of External Consultants when it assigned work relating to the Project to Electronic Warfare Associates Canada (EWA) without a Request for Proposals (RFP) or without approval from the Lieutenant-Governor in Council. As at 31 March 2007, EWA received a total of approximately \$125,000 and the work is still ongoing.

Government did not comply with the Atlantic Procurement Agreement (APA) because it did not publicly tender in the Atlantic region. Unlike our *Public Tender Act*, and the Agreement on Internal Trade, the APA does not permit an exemption for economic development purposes.

Government did comply with the *Public Tender Act*. In accordance with the *Act*, the Lieutenant-Governor in Council, on the recommendation of the Minister of Innovation, Trade and Rural Development, exempted the Project from a public tender call because it qualified as an economic development initiative.

- **Whether Government's Commitment was Based on a Comprehensive Review**

Government exercised due diligence in assessing the proposal and negotiating the final Agreement. Government's due diligence process for projects of this magnitude would include a review by the originating Department i.e. the Department of Innovation, Trade and Rural Development, the Department of Finance, Cabinet Secretariat officials and any other Departments with requisite expertise.

The initial assessment process at the Department of Innovation, Trade and Rural Development did not include an adequate evaluation of Project costs, benefits and risks. It was not until the Department of Finance and Cabinet Secretariat officials became involved that sufficient information was provided to Cabinet. It could be argued that the due diligence process worked in this instance and that, as a result of the involvement of other Departments with requisite expertise, an adequate assessment was performed. However, we believe the Department of Innovation, Trade and Rural Development should have done more. A contributing factor to the weak assessment process may be the result of the Department not having a formal documented process for assessing unsolicited proposals (such as this Project) which do not qualify for funding under an established funding program.

- **Whether Government Will Receive Value for its Planned Investment**

The Province did receive good value for its \$15 million investment. Before this Project, Newfoundland and Labrador was the only jurisdiction in Canada with just one fibre optic provider (i.e. monopoly). There are a host of economic and non-economic benefits resulting from having a redundant fibre optic line such as increased penetration of broadband access among businesses and households, fuller participation in medical and academic research efforts, improved speed of medical consultation with experts residing in other provinces, and economic benefits from the construction and operation of the network. As well, EWA indicated that Government is receiving value in excess of the \$15 million purchase price.

- **Any Other Matters of Significance**

- (i) ***Lobbyist Registration Act***

Persona officials were not required to register under the *Lobbyist Registration Act* because, as determined by the Commissioner of Lobbyists, Persona employees' lobbying activities did not occupy 20% or more of the equivalent of one staff member's full-time work.

- (ii) **What Did We Buy**

It is important to understand that Government's commitment to spend \$15 million on this Project relates to the acquisition of dark fibre i.e. strands of fibre that will have to be connected to sophisticated electronics before it becomes operational. It is expected that it will cost an additional \$15 to \$20 million to operationalize the fibre by 2008. Furthermore, this is only the first step of a 10 year plan which may cost up to \$200 million to fully develop Government's telecommunications infrastructure which all Government departments and public sector entities, such as the health and education sectors, are expected to use. By using its own telecommunications infrastructure, Government expects cost savings that will defray some of the development costs; however, that remains to be seen.



JOHN L. NOSEWORTHY, CA
Auditor General

Background

1. Announcement and Proposal Overview

Government announces \$15 million dollar investment in fibre optic project

On 2 November 2006, the Government of Newfoundland and Labrador announced it would

“...invest \$15 million, over the next two fiscal years on the installation of a fully redundant fibre optic link which will run from St. John's to Halifax along two diverse routes to connect the national carriers into mainland Canada.”

The announcement stated that, *“For its investment, Government will assume an ownership position of dedicated fibre optic lines that will be utilized as it rolls out its broadband initiative.”*

The proposed investment was referred to in the House of Assembly resolution as the "fibre optic deal" (the Project). The Project proposal was first received from Persona Communications Corp. (Persona) in the form of a Power Point presentation to the Executive Council in July 2005, to the Department of Innovation, Trade and Rural Development (the Department) in the form of a summary in September 2005 and finally as a formal submission to the Department in December 2005.

Under the Project, Persona and two other companies, Rogers Communications and MTS Allstream, would provide a total of \$37 million towards the new initiative, which together with Government's \$15 million investment, would result in a total investment of \$52 million.

Proposed Project

Under the Project, Persona would construct a second fibre optic link between St. John's and Halifax (the nearest point with access to multiple fibre networks) in a “ring configuration” which would include a Northern Terrestrial Route and a Southern Coastal Route as follows:

- The Northern Terrestrial Route would follow the Trans Canada Highway from St. John's to Channel-Port aux Basques and cross the Gulf to Cape Breton Island, and then follow the highway into Halifax.

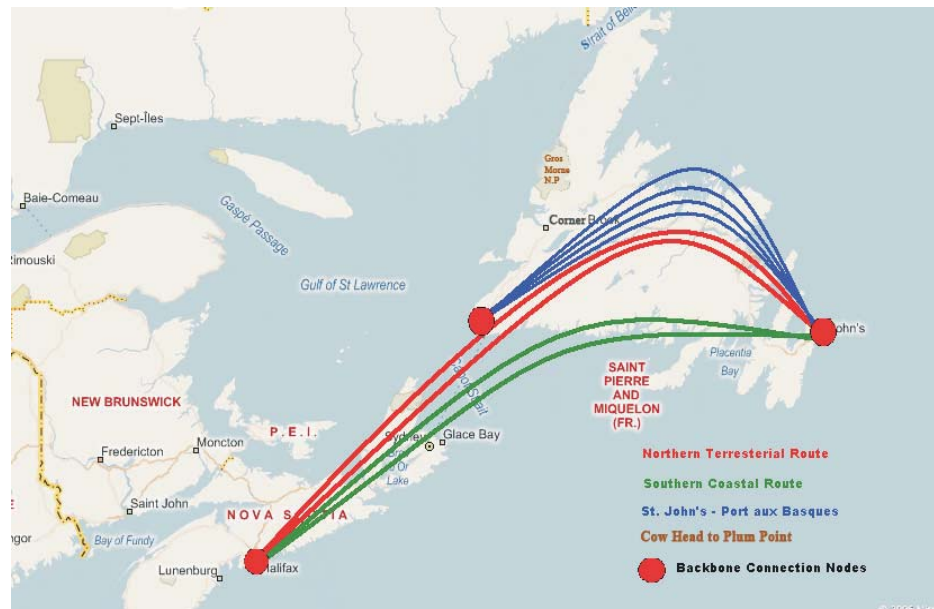
- The Southern Coastal Route would leave St. John's and travel through Bay Bulls to Placentia, cross Placentia Bay and the Burin Peninsula, travel underwater to Harbour Breton, then underwater to Rose Blanche, cross the Gulf to Cape Breton Island and then follow secondary roads to Halifax.

At the time of this proposal, Aliant owned the only fibre optic link between St. John's and Halifax.

The routes of the fibre optic link as outlined in the Project are presented in Figure 1.

Figure 1

Fibre Optic Link Route



Source: Government of Newfoundland and Labrador

Final Agreement signed

The final Agreement (the Agreement) was completed and signed by Government and Persona on 18 July 2007. Under the Agreement, the Province will receive an Indefeasible Right to Use (IRU) eight fibre optic strands for a 20 year term. Each fibre optic cable will contain from 24 to 96 strands, depending on the route. In total, the Province will own 8 strands within the fibre optic cables. This will include 6 fibre optic strands in the Northern Terrestrial Route and 2 strands in the Southern Coastal Route.

In addition, Persona will provide, at no additional cost:

- all maintenance on the strands for the first 10 years; and
- 4 additional strands between Deer Lake and St. Anthony, if and when that route is built.

The Agreement is renewable for up to 4 additional 20 year terms, at no extra cost. Government will be responsible for maintenance costs after the initial 10 year period on a basis equal to that of the other companies involved.

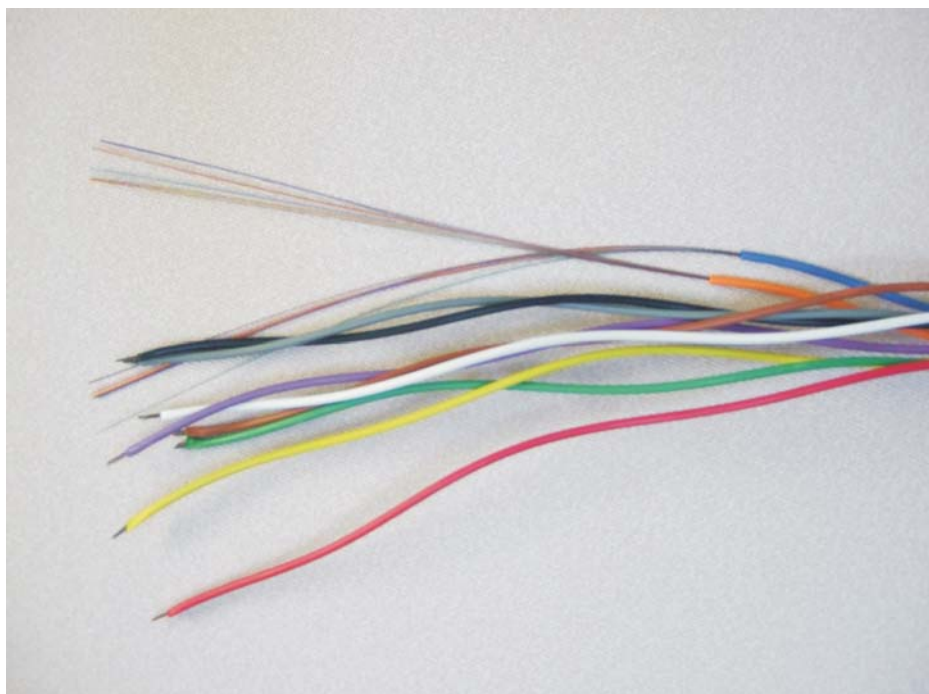
Timelines

Placement of the fibre optic cables for the Northern Terrestrial Route and Southern Coastal Route was estimated to be completed by 31 December 2007. If and when Persona builds a line between Deer Lake and St. Anthony, the Province will own 4 strands on that line at no additional cost. Timelines for connecting this route will be developed at a later date by Persona.

Figure 2 shows the strands within a fibre optic cable.

Figure 2

Strands within a Fibre Optic Cable



Source: Government of Newfoundland and Labrador

Fibre optic cable will be operational in 2008

As a result of this Project, the Province will essentially own the foundation (fibre optic strands) on which its telecommunications will run. However, to light up and operationalize the strands, the Province will incur additional costs that are estimated to run between \$15 and \$20 million. As such, the Department plans to issue a Request for Proposals (RFP) for the supply of telecommunications services on the strands. The network is expected to be operational during 2008.

Government Broadband Initiative

Operationalizing the fibre optic strands is one of the first steps under the Government Broadband Initiative (GBI) to fully develop Government's telecommunications infrastructure. Over 10 years of the GBI, Government estimates it will spend up to \$200 million to complete the infrastructure which all departments and public sector entities, such as the health and education sectors, are expected to use for their telecommunications.

Benefits from the Project

Government officials indicated that the development of fibre optic technology in the Province will result in significant service enhancements and cost savings for Government and the business sector.

As for residential service, while there will be increased availability of broadband services throughout the Island portion of the Province, there will be no significant cost savings.

Labrador will be connected to the network through a separate project under the GBI at a later date.

The Department's external consultant advised that the benefits from the Project include:

- increased penetration of broadband access among businesses and households;
- improved public services, e.g. in provision of health care services and enhanced educational opportunities through distance learning;
- economic benefits which accrue from the construction and operation of the network;
- economic benefits that result from the existence and use of the broadband network, e.g. jobs associated with new businesses that choose to locate in the region because of the broadband network;
- benefits from the Province's share of any underlying rights (pole rentals, easements, etc.) at no cost for the first 20 years;
- provision of equipment racks and other space by Persona as required for equipment and connection at each hub site;
- fuller participation in medical and academic research efforts nationally and internationally;

-
- improved speed of medical consultation with experts residing in other provinces;
 - a more competitive environment in the communications industry; and
 - attraction of additional businesses and industries to the Province.

The Province intends to use the fibre for its own purpose which complies with Canadian Radio-Television and Telecommunications Commission (CRTC) Guidelines. The purchased strands will provide Government and all of its public sector entities, including Memorial University of Newfoundland, the College of the North Atlantic, and the Regional Integrated Health Authorities, with significantly increased capacity for all of their telecommunication requirements.

Officials interviewed indicated that all of Government's current telecommunications requirements can be met on two strands of fibre. As a result of this Project, there will be excess capacity or dark strands which will be held for future use.

2. Request for Auditor General to Conduct a Review

Questions from the Opposition

During the Fall 2006 sitting of the House of Assembly, there was a significant amount of discussion relating to the process followed and the Premier's involvement in the Project. During this discussion, Government indicated that the Project was an economic development initiative and that neither a public tender nor a request for proposals (RFP) would be issued.

Discussion at the Public Accounts Committee

In November 2006, at an in-camera meeting of the Public Accounts Committee, it was discussed whether the Committee would support having the Auditor General and the Public Accounts Committee carry out an investigation into the proposed Project. However, the Government majority on the Public Accounts Committee was not supportive of this action.

Auditor General asked to investigate

On 27 November 2006, the Speaker of the House of Assembly wrote the Auditor General advising of a resolution passed by the House of Assembly on 22 November 2006, which provided that the Auditor General be asked to “...investigate all the details and circumstances of the fibre optic deal.” In the letter, the Speaker requested that the Auditor General undertake the review. The resolution stated:

“WHEREAS \$15 million in taxpayers money has been allocated for a project to bring two additional fibre optic cables to the Province in a deal which involves close personal friends and business associates of the Premier without a call for public tenders or a request for proposals; and

WHEREAS many significant concerns have been raised about the lack of analysis, the role of lobbyists, the disclosure of a benefits analysis, the exploration of other options and the procedures followed in allocating this money; and

WHEREAS the Government majority on the Public Accounts Committee did not support the Auditor General and the Public Accounts Committee carrying out an investigation into this matter;

THEREFORE BE IT RESOLVED that the House of Assembly in the spirit of openness and accountability, ask the Auditor General, an independent Officer of the House of Assembly, to investigate all the details and circumstances of the fibre optic deal.”

**Auditor
General accepts
resolution**

On 30 November 2006, the Auditor General wrote the Speaker of the House of Assembly advising that the Office would accept the resolution to review the Fibre Optic Deal (the Project) and that pursuant to section 16 of the *Auditor General Act*, the report resulting from the review would be provided to the House of Assembly.

**Auditor
General
commences
review**

On 7 December 2006, the Auditor General met with the Government House Leader, the Opposition House Leader and the Leader of the New Democratic Party, to discuss the Auditor General's understanding of the resolution and to consider expectations of the Members of the House of Assembly.

On 14 December 2006, officials from the Auditor General's Office first met with officials from the Department to commence the audit.

Objectives and Scope

Objectives

In a tentative scope document provided to the Government House Leader, the Opposition House Leader and the Leader of the New Democratic Party in February 2007, it was indicated that the objectives of the review of the Project would be to determine:

- whether Government complied with legislation and other authorities;
- whether Government's commitment was based on a comprehensive review of information necessary to make a sound business decision;
- whether Government will receive value for its planned investment; and
- any other matters of significance that come to our attention.

In addition, given the reference in the resolution, to “...*a deal which involves close personal friends and business associates of the Premier...*,” it was indicated to the party leaders that the review would also include determining whether the Premier was involved in the Project.

Scope

We completed our review of the Project in September 2007. The review included an examination of over 50,000 pages of Government documents relating to the Project. It also included interviews with 30 individuals including Government officials, proponents of the Project, competitors and technical experts (Appendix A).

All of our work was performed in accordance with Generally Accepted Auditing Standards and included such tests and other procedures as we considered necessary in the circumstances.

Access granted to Cabinet documents

We note that under the *Auditor General Act*, our Office is not permitted access to Cabinet documents. However, on 25 April 2007, Cabinet issued the following directive that provided unprecedented access to Cabinet documents related to the Project:

“Due to the unique circumstances imposed by the Resolution of the House of Assembly dated November 22, 2006, the Lieutenant Governor in Council hereby directs that the Auditor General be granted access to the following information contained in a confidence of the Executive Council relating to the proposal to establish an off-island fibre-optic communications link... with such information to remain a confidence of the Executive Council for all other purposes including the purposes of any Act of the Legislature.”

**Review not
typical of
others
completed**

This review was not typical of others carried out by my Office in that it was not conducted after public money had been expended. In fact, when we started our review in December 2006, negotiations with Persona were ongoing and no contract had been signed. The final Agreement was not signed until 18 July 2007 and the first disbursement of \$5 million was not made until August 2007, some 8 months after we started our review.

Detailed Observations

**Detailed
findings**

In meeting the objectives of this review, we organized our findings into the following major sections:

1. Whether the Premier was Involved in the Project
2. Compliance with Legislation and Other Authorities
3. The Assessment Process, including Value of Planned Investment

For information purposes, the following Appendices are attached:

Appendix A: List of Interviewees
Appendix B: Significant Provisions of the Final Agreement
Appendix C: Key Terms and Concepts
Appendix D: Background - Broadband Strategy

1. Whether the Premier was Involved in the Project

Introduction

The resolution passed by the House of Assembly on 22 November 2006 asking the Auditor General to investigate all the details and circumstances of the Project noted that the deal involved “*close personal friends of the Premier.*”

As a result, one of the objectives of our review was to determine whether the Premier was involved in the Project and in the decision making process of Cabinet leading to approval of the Project and the final Agreement.

No evidence found to indicate that the Premier was involved in the Project

Our review of documentation, including unprecedented and unrestricted access to Cabinet documents, as well as formal interviews with 30 individuals, disclosed no evidence that the Premier was involved in the Project.

In addition, on 21 December 2006, the Premier provided my Office with an affidavit indicating that he did not participate in the Cabinet decision of 26 October 2006 which gave approval in principle for Government to participate in the Project with Persona.

While not related to the Project, the only evidence we saw regarding the Premier's connection was that on 17 May 2005 he wrote the Federal Minister of State (Infrastructure and Communities) requesting Federal funding to match Persona's \$15 million proposed contribution to develop a fibre network. No Federal funding was provided.

2. Compliance with Legislation and Other Authorities

Introduction

One of the objectives of our review was to determine whether Government complied with legislation and other authorities including the:

- *Public Tender Act;*
- Agreement on Internal Trade;
- Atlantic Procurement Agreement;
- Guidelines Covering the Hiring of External Consultants; and
- *Lobbyist Registration Act.*

Conclusions

We have concluded that:

- The Department complied with the *Public Tender Act* by obtaining approval of the Lieutenant-Governor in Council for an exemption from calling tenders because it qualified as an economic development initiative.
- The Department complied with the documentation requirements under the Agreement on Internal Trade to exempt the Project.
- Government did not comply with the Atlantic Procurement Agreement (APA) because it did not publicly tender in the Atlantic region. Unlike our *Public Tender Act*, and the Agreement on Internal Trade, the APA does not permit an exemption for economic development purposes.
- The Department complied with the Guidelines Covering the Hiring of External Consultants in engaging Electronic Warfare Associates (EWA) for the **GBI**. However, the Department did not comply with the Guidelines when it assigned work to EWA relating to the **Project** without an RFP or without approval from the Lieutenant-Governor in Council.
- Persona officials were not required to register under the *Lobbyist Registration Act* because, as determined by the Commissioner of Lobbyists, Persona employees' lobbying activities did not occupy 20% or more of the equivalent of one staff member's full-time work.

Detailed findings to support our conclusions are contained in the following sections.

A. Legislation Governing the Acquisition of Goods and Services

**The
Department
complied with
the *Public
Tender Act***

(i) *The Public Tender Act*

The resolution passed by the House of Assembly expressed concern that money for the Project had been allocated without a call for public tenders or a Request for Proposals. Section 3(1) of the *Public Tender Act* requires that:

“Where a public work is to be executed under the direction of a Government funded body or goods or services are to be acquired by a Government funded body, the Government funded body shall invite tenders for the execution or acquisition.”

In response to questions raised by the Opposition in the House of Assembly on the process followed, Government indicated that the Project was an economic development initiative and that a public tender or RFP would not be issued as it was deemed by the Department to be exempt from the public tendering requirement. Section 3(2)(i) of the *Public Tender Act* provides this exemption:

“...where in the opinion of the Minister of Industry, Trade and Technology and subject to the approval of the Lieutenant-Governor in Council, the work or acquisition is for an economic development purpose.”

In accordance with the *Public Tender Act*, the Lieutenant-Governor in Council exempted the Project from a public tender call for economic development purposes.

In cases where tenders are not invited because of economic development reasons, the head of the Government funded body must inform the Government Purchasing Agency (GPA). In turn, the GPA must table a report with the Speaker of the House of Assembly explaining the reasons why a public tender was not invited.

In August 2007, the Department filed the necessary information with GPA for tabling in the House of Assembly.

Our review indicated that Government did comply with the *Public Tender Act*. In addition, we met with the Chief Operating Officer of the GPA who indicated that, in his opinion, the Project was exempt from the *Act*.

**The
Department
complied with
the Agreement
on Internal
Trade**

(ii) The Agreement on Internal Trade

The Agreement on Internal Trade (AIT) is an intergovernmental agreement among the Federal Government, the Provinces, and the Territories to reduce and eliminate barriers to the free movement of people, goods, services and investments within Canada. Under the Agreement, these governments agreed to apply the principles of non-discrimination, transparency, openness and accessibility with respect to their procurement opportunities and those of their municipalities and municipal organizations, school boards and publicly funded academic, health and social services entities. Article 508 of the AIT provides that:

“A Party may, under exceptional circumstances, exclude a procurement from the application of this Chapter for regional and economic development purposes...”

This article requires that a notice providing details of the exceptional circumstances of all such excluded procurements be provided. The Department filed the required information and has therefore complied with the AIT.

**The Province
did not comply
with the
Atlantic
Procurement
Agreement**

(iii) The Atlantic Procurement Agreement

The Atlantic Procurement Agreement (APA) is an agreement among the Atlantic Provinces with the purpose of eliminating all forms of discrimination among the participating Governments and public entities within their jurisdiction.

The APA applies to public sector procurement contracts relating to goods, services and construction awarded by government funded bodies, including departments, agencies, commissions and crown corporations.

Even though there is a reporting framework under section 9, the APA does not permit an exemption for economic development purposes. Therefore, the Province has not complied with the APA.

(iv) Guidelines Covering the Hiring of External Consultants

In June 2006, the Department hired Electronic Warfare Associates (EWA) through a public RFP under the Guidelines Covering the Hiring of External Consultants (the Guidelines) as an external independent consultant to provide advice relating to the GBI project. The Department estimated the original work to be approximately \$200,000 over a three month period.

Payments for this work to 31 March 2007 totalled \$290,512 and work is still ongoing, eleven months beyond the original timeframe. Figure 3 provides details on the \$290,512.

Figure 3

**Payments to EWA for GBI
by the Department of Innovation, Trade and Rural Development
Fiscal Year 2006-07**

Payment Date	Description of Work	Amount
3 Nov. 2006	Project Planning and Development	\$ 150,000
29 Jan. 2007	Broadband Support	49,950
31 Mar. 2007	Project Planning and Development	10,000
31 Mar. 2007	GBI Service Management Centre Definition	38,275
31 Mar. 2007	Technical and Financial Feasibility Analysis on Potential Fibre Optic Connection through Labrador	42,287
	Total	\$ 290,512

Source: The Department of Innovation, Trade and Rural Development

The Department did not fully comply with the Guidelines Covering the Hiring of External Consultants

In June 2006, Treasury Board directed the Department to: engage an external consultant to confirm the financial viability of the Project, determine whether the Project would result in competitive telecommunication costs for the Province, complete financial due diligence with respect to the business case and complete an examination of the value to Government of owning dark fibre.

The Department did not proceed with an RFP to engage an industry expert to conduct the review directed by Treasury Board and did not seek authority from the Lieutenant-Governor in Council to waive application of the Guidelines. The Department felt that, because it had engaged EWA through a public RFP process to perform work under the GBI, it would be more timely and efficient to use them to complete the work relating to the Project.

In our opinion, as the Project did not become part of the GBI until October 2006, awarding this additional work to EWA was not appropriate because it was not included in the original scope approved by the Lieutenant-Governor in Council. Therefore, the Department did not comply with Government's Guidelines. As Figure 4 shows, to 31 March 2007, the Department paid EWA a total \$125,410 relating to its review of the Project.

Figure 4

**Payments to EWA for the Project
by the Department of Innovation, Trade and Rural Development
Fiscal Year 2006-07**

Date	Description of Work	Amount
3 Nov. 2006	Trans Gulf Benefits and Valuation	\$ 21,725
3 Nov. 2006	Review of Persona Project proposal	39,785
31 Mar. 2007	Independent Verification Monitoring of Trans Gulf Project Engineering Build	23,900
31 Mar. 2007	Trans Gulf Valuation	40,000
	Total	\$ 125,410

Source: The Department of Innovation, Trade and Rural Development

B. Other Legislation

Persona officials were not required to register under the *Lobbyist Registration Act*

(i) *Lobbyist Registration Act*

The resolution passed by the House of Assembly on 22 November 2006 expressed concern about the role of lobbyists in relation to the Project. Therefore, one of the objectives of our review was to determine whether Persona officials were required to register as lobbyists under the *Lobbyist Registration Act*.

The purpose of the *Lobbyist Registration Act* is to identify and register lobbyists who are paid to lobby Government on behalf of client companies. To qualify as an in-house lobbyist, an employee's lobbying activities, alone or combined with other employees, must occupy 20% or more of one staff member's full-time work.

Our review indicated that Persona officials were not required to register under the *Lobbyist Registration Act* because, as determined by the Commissioner of Lobbyists, Persona employees' lobbying activities did not occupy 20% or more of the equivalent of one staff member's full-time work.

3. The Assessment Process, including Value of Planned Investment

A. Internal Government Review

Introduction

The resolution passed by the House of Assembly on 22 November 2006 noted that there were concerns about the Project in terms of the lack of analysis, the disclosure of a benefits analysis and the procedures followed in allocating public funds. As a result, we reviewed the due diligence process followed by Government to determine whether it was adequate.

Government's due diligence process for projects of this magnitude would include a review by the originating Department i.e. the Department of Innovation, Trade and Rural Development, the Department of Finance, Cabinet Secretariat officials and any other Departments with requisite expertise. We found that Government exercised due diligence in assessing the proposal and negotiating the final Agreement.

However, the initial assessment process at the Department of Innovation, Trade and Rural Development did not include an adequate evaluation of Project costs, benefits and risks. It was not until the Department of Finance and Cabinet Secretariat officials became involved that sufficient information was provided to Cabinet. It could be argued that the due diligence process worked in this instance and that, as a result of the involvement of other Departments with requisite expertise, an adequate assessment was performed. However, we believe the Department of Innovation, Trade and Rural Development should have done more.

A contributing factor to the weak assessment process may be the result of the Department of Innovation, Trade and Rural Development not having a formal documented process for assessing unsolicited proposals (such as this Project) which do not qualify for funding under an established funding program.

Details on our review of the due diligence process are outlined as follows.

Project not subject to comprehensive assessment at the Department

The Department has various programs for projects requiring funding to a maximum of \$500,000; however, there are no funding programs or assessment guidelines for proposals requiring funding exceeding \$500,000. The Department considers these projects to be “one-of” situations which are assessed on their own merit.

While we do not challenge the position of the Department in not having a policy to assess these “one-of” projects, we did note that this Project was not subject to a comprehensive assessment within the Department.

The inadequacy of the assessment was evidenced by the deficiencies noted by officials of the Department of Finance and Cabinet Secretariat when they performed their due diligence. These deficiencies related to the fact that Project costs, benefits and risks had not been addressed prior to the submission being forwarded to Cabinet.

Details of our findings with regards to the assessment of the Project are as follows:

(i) The Department of Finance and Cabinet Secretariat

In May 2006, officials of the Department of Finance and Cabinet Secretariat reviewed the Project and the Department of Innovation, Trade and Rural Development's draft Cabinet submission, and forwarded their comments to the Department for clarification and/or action. Issues raised included:

- the lack of a business case or risk analysis for Government's \$15 million investment;
- the lack of employment information provided with the Project;
- the lack of information of the impact on Government's financial position;
- the need for an expert assessment of the Project;
- that they were unable to determine if the \$52 million in construction costs or maintenance costs were reasonable;
- the lack of identification and description of the Project risks;
- the lack of review of projected capital expenditures for reasonableness and the risks of cost overruns, and how they will be handled;
- the lack of an estimate of the valuation of the fibres;
- the lack of an estimate and quantifying of the benefits for the economy and Government;
- the lack of an assessment of the competitive environment and broadband prices after the Project is completed; and
- the lack of an opinion on whether ownership of fibres will safeguard competition in the long-term.

In conclusion, Department of Finance officials indicated that the “paper may be premature.”

(ii) The Department of Innovation, Trade and Rural Development

In a June 2006 meeting of the Department, the Department of Finance and Cabinet Secretariat to discuss the draft Cabinet submission, there was a view expressed that sufficient information had not been provided on the overall benefits to the Province, particularly regarding the cost savings on the current level of telecommunication usage.

Subsequent to the meeting, the Department put forward a submission to Cabinet Secretariat recommending that Government agree in principle to a maximum \$15 million investment subject to an independent valuation of the asset.

On 17 June 2006, the submission was deferred by Cabinet. Department officials indicated that the submission was deferred because the Project's external assessment had not been completed. The Department then arranged for EWA to complete the assessment, with the resulting report, dated 20 June 2006, being attached to another submission to Cabinet on 21 June 2006.

On 21 June 2006, the submission was rejected, this time by Cabinet. Departmental officials indicated that the submission was rejected because direct benefits to the Province for its \$15 million investment were not adequately identified.

The final submission to Cabinet was forwarded in October 2006. At a meeting held on 26 October 2006, Cabinet provided approval in principle for the Project. After it received the direction of Cabinet, the Department focused on ensuring that Cabinet's directives were reflected in the final Agreement. This process also involved further assistance and advice of the Department of Finance, Cabinet Secretariat and the Department of Justice in negotiating the final Agreement, which was signed on 18 July 2007.

(iii) The Department of Justice

The Department of Justice provided legal advice and direction during the assessment phases of the Project from December 2005 to October 2006, up to and including the development and conclusion of a final Agreement in July 2007.

The Department of Justice and the external legal advisors provided legal advice and assistance on all aspects of the Project and the final Agreement to ensure compliance with all of Cabinet's directives.

B. External Review

Introduction

We reviewed the advice provided to the Department by external consultants. EWA and Bennett Jones LLP provided advice on the Project and Borden Ladner Gervais LLP provided advice on preparing the final Agreement.

The following sections summarize the advice provided by these consultants.

(i) EWA Analysis

In accordance with Generally Accepted Auditing Standards, we performed a review of EWA's work and findings to assess whether, under Generally Accepted Auditing Standards, we could place reliance on their work.

We met with EWA and obtained, through enquiry and discussion, reasonable assurance of EWA's: expertise, competence and integrity; relevance of their expertise to the objective of our review; and their objectivity and appropriate degree of independence.

As a result of this review we concluded that EWA does meet the requirements under Generally Accepted Auditing Standards and that we could place reliance on their work relating to our review of the Project.

The work conducted by EWA is outlined as follows:

In June 2007 EWA performed their final review of the overall reasonableness of the Project prior to final approval and signing of the final Agreement by Government. EWA concluded that:

- Nothing came to their attention to indicate any major financial or technical shortcomings in the Project;
- Government is receiving value in excess of the purchase price of \$15 million in the Project;

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- The \$15 million purchase is for the fibre component only and completing the system will require further investment (in related electronics and other infrastructure components) as part of currently planned associated projects (GBI);
 - The average cost of Government's per kilometre fibre is lower than the typical industry value;
 - Included in the contract is 10 years of maintenance which Government is effectively getting at no additional cost;
 - Government is currently spending approximately \$6-7 million annually for data services. It is anticipated that Government should realize a 50% savings (conservatively). Assuming this 50% reduction, Government should recover its investment within 5 years;
 - Persona has guaranteed to cover any Project cost overruns; and
 - As at 15 June 2007, the Project was well over 50% complete. The estimated completion date is by 31 December 2007. Given the relatively short time frame to completion and the level of progress to date, the opportunity for cost overruns has been minimized.

EWA also engaged a subcontractor to complete a review of Persona's financial statements and the financial aspects of the Project. EWA concluded that:

- Persona's independently audited financial statements as of 31 December 2006, and internally prepared financial statements as of 31 March 2007, show that Persona is financially able to handle any cost overruns.
- Government is not in a position to invest in building the entire infrastructure on its own;
- No subsequent events occurred from Persona's 31 December year end to March that would affect Persona's viability; and
- Looking at the Project in isolation, the \$15 million dollar investment from Government was required.

(ii) Bennett Jones LLP

The law firm of Bennett Jones LLP was initially engaged by the Department of Justice to provide legal advice relating to the Project. Their preliminary findings indicated that nothing in the *Telecommunications Act* prohibits a Canadian government from being a direct owner of a fibre optic inter-provincial transmission line. Additionally, if the Province uses the fibre for its own purposes and does not provide telecommunications services to third parties it will not be considered a carrier under CRTC regulations.

Bennett Jones advised that the Project does not raise *Competition Act* concerns and that the CRTC is of the view that a second undersea facility is considered pro-competitive.

(iii) Borden Ladner Gervais LLP

The law firm of Borden Ladner Gervais LLP was engaged to assist Government in preparing the final Agreement between Government and Persona dated 18 July 2007.

Appendix A: List of Interviewees (by date of interview)

	Name	Position	Department /Entity	Date of Interview
1	Dennis Hogan	Assistant Deputy Minister of Innovation, Research and Advanced Technologies	Innovation, Trade and Rural Development	First met on 14 December 2006 then several meetings afterwards
2	Diane Hooper	Director of Innovation, Research and Advanced Technologies	Innovation, Trade and Rural Development	First met on 14 December 2006 then several meetings afterwards
3	Robert Parsons	Senior Accounts Officer	Innovation, Trade and Rural Development	First met on 18 December 2006 then several meetings afterwards
4	Derek Staubitzer	Director of Strategic Partnerships	Innovation, Trade and Rural Development	First met on 16 January 2007 then several meetings afterwards
5	William MacKenzie	Former Acting Deputy Minister, now Clerk of the House of Assembly	Innovation, Trade and Rural Development	12 January 2007
6	Dave Penney	Director of Infrastructure - Hosted Services	Office of the Chief Information Officer	22 January 2007
7	Brian Evans	Director of Federal Provincial Agreements Division	Education	26 January 2007
8	Jim Tuff	Director of the Centre for Distance Learning and Innovation	Education	26 January 2007
9	Michael Howard	Senior Advisor Government Relations	Bell Aliant Regional Communications	2 April 2007
10	Larry Cahill	Chief Operating Officer	Government Purchasing Agency	3 April 2007
11	Don Kavanagh	Director of Business Analysis	Innovation, Trade and Rural Development	5 April 2007
12	Doug House	Former Deputy Minister, now Deputy Minister of Provincial Development Plan	Innovation, Trade and Rural Development	1 June 2007
13.	Gerard Dunphy	Manager of Telecontrol Engineering	Newfoundland and Labrador Hydro	3 June 2007

	Name	Position	Department /Entity	Date of Interview
14	LeeAnn Montgomery	Commissioner of Lobbyists	House of Assembly	6 June 2007
15	Donna Brewer	Assistant Deputy Minister of Financial Planning and Benefits Administration	Finance	7 June 2007
16	Earl Saunders	Director of Administration, Loans and Debt Management	Finance	7 June 2007
17	Brian Hurley	Director of Project Analysis Division	Finance	7 June 2007
18	Rod Forsey	Director of Economic Research and Analysis Division	Finance	7 June 2007
19	Dean MacDonald	Chief Executive Officer	Persona Communications Corp.	8 June 2007
20	Paul Hatcher	Chief Operating Officer	Persona Communications Corp.	8 June 2007
21	Ron Williams	Comptroller General	Finance	12 June 2007
22	Cathy Duke	Deputy Minister	Innovation, Trade and Rural Development	13 June 2007
23	Tom Fleming	Manager Trade Policy	Innovation, Trade and Rural Development	13 June 2007
24	Reg Locke	Senior Solicitor	Justice	14 June 2007
25	Christine Healy	Solicitor	Justice	14 June 2007
26	Peter Fitzgerald	Solicitor	Justice	14 June 2007
27	Paul Zatychech	Director	EWA Canada	27 June 2007
28	Joe Dawson	Regional Manager - St. Johns	EWA Canada	27 June 2007
29	David Maywood	Consultant	Ibiska	27 June 2007
30	John Frouin,	Chartered Accountant	Frouin Group	27 June 2007

Appendix B: Significant Provisions of the Final Agreement

The final Agreement (the Agreement) with Persona was signed by the Minister of Innovation, Trade and Rural Development and the Minister of Finance on behalf of the Province on 18 July 2007.

The Agreement acknowledged that Persona is constructing a terrestrial and undersea fibre optic cable facility between St. John's and Halifax in a ring configuration. In the Agreement, Persona agreed to transfer to the Province, an exclusive, irrevocable Indefeasible Right to Use (IRU) certain dark fibres in the facility. The Agreement also set forth the terms and conditions that apply to the transfer of these exclusive IRUs.

The following are the significant provisions of the final Agreement:

- The Province will pay Persona \$15 million for the IRU:
 - 2 strands of fibre on the northern route from St. John's to Halifax;
 - 4 strands of fibre on the northern route from St. John's to Channel-Port aux Basques; and
 - 2 strands of fibre on the southern coastal route from St. John's to Halifax.
- If and when Persona constructs a fibre optic facility between Deer Lake and St. Anthony, the Province will receive at least 4 strands of fibre on such facility at no cost.
- The initial term for the IRU Agreement is 20 years and the Province may extend the Agreement for four additional terms of 20 years each at no cost.
- Persona will provide maintenance for the first 10 years at no cost.
- Rates to be charged for maintenance after the first 10 years are to be equal to the Province's proportionate share of the costs incurred by Persona in providing the services plus a margin of 25% to cover non-billable costs such as special tools, vehicles, computers and accounting costs. The Agreement provides that neither Rogers nor MTS Allstream will have more favourable rates or conditions for their maintenance costs than the Province.

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- In consideration for the IRU, the Province will pay to Persona:
 - \$5 million in August 2007.
 - \$2.5 million on 1 October 2007.
 - \$2.5 million on 1 January 2008.
 - \$2.5 million on 1 April 2008.
 - \$2.5 million on 1 July 2008.
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Future costs

The Province's future costs will include:

- connection of its telecommunications system with the IRU fibres at each of the Persona hub sites;
- the Province must pay Persona at fair market rates for each connection performed by Persona or its subcontractors;
- the right of the Province's personnel and subcontractors to perform connections at or to have access to Persona hub sites is subject to escort by authorized personnel of Persona, and such escort will be at the Province's expense at \$75 per hour during the initial term, and at fair market rates during the IRU renewal terms;
- interconnections at a splice enclosure along the facility will be permitted with the Province paying Persona the fair market rate for the provision and installation of a stub cable;
- the Province will be solely responsible for any costs to remove and relocate its equipment housed at Persona hub sites in the event that a Persona hub site ceases to be available for use by the Province for reasons beyond Persona's control;
- the Province must purchase space and power as required at Persona hub sites. The Province must pay Persona a monthly fee for each Persona hub site in the amount of \$500 plus an inflation factor;
- the Province will be required to reimburse Persona for all one-time costs incurred by Persona in providing power to the Province at hub sites;
- if the Province elects to make use of any Persona owned towers, it will pay Persona an antenna fee based upon fair market rates for the provision of facilities;

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- the Province will provide its own optronics or electronics, or optical or electrical equipment, or other additional facilities including generators, batteries, air conditioners, fire protection and monitoring and testing equipment;
 - any segregation of equipment and facilities by the Province will be at its expense and any costs by other parties to assist any segregation are to be reimbursed by the Province;
 - if there is a catastrophic failure (such as a major fibre cut) costing over \$500,000 in a calendar year, the Province will pay its proportionate share of the costs of restoring the facility;
 - the Province will reimburse Persona for the Province's share of the costs to Persona for renewal or extension of any Persona underlying rights after year 20 (underlying rights include easements, rights of way, licenses, authorities, permits etc.);
 - if the Province wishes to light up its fibres or make a connection anywhere along the network it will be responsible for the costs;
 - if the Province decides it wants space at the hub sites it will have to pay its portion of the costs such as air conditioning, back up power, etc.;
 - if the Province has done something that requires a repair it will reimburse Persona for the costs;
 - the Province will pay
 - 100% of the costs associated with any relocation or repair to IRU fibres if they are a result of any direct or indirect act or failure by the Province; and
 - its share of the costs associated with any relocation or repair to IRU fibres if they are a result of any person other than Persona, the Province or their respective affiliates, should Persona not recover such costs from the person whose act or failure to act necessitated the relocation or repair.
 - the Province will pay its portion of annual imposition costs (taxes or fees) at a cost to be determined once the actual numbers are known;

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- the Province will pay any costs associated with removal of its electronics, equipment or other property from the IRU fibres upon expiration or termination of the Agreement; and
 - the Province will bear its own costs and expenses if it wishes to have the records of Persona audited.
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Appendix C: Key Terms and Concepts

Redundancy

In electrical engineering redundancy refers to the installation of duplicate electronic or mechanical components or backup systems that are designed to come into use to keep equipment working if their counterparts fail.

Fibre optic cable

A fibre optic cable carries a digital signal via pulses of light through a very thin strand of glass. Fibre strands contained in the core of the fibre optic cable are extremely thin, no thicker than a human hair. The fibre itself has no digital capacity. The digital capacity of each strand is dependent on the equipment attached at each end, i.e. equipment transmitting and receiving the data. This equipment can be upgraded to accommodate higher speed/capacity as needed.

Fibre strands are ‘lit’ when being used for communications and are essentially the transport medium for information as it travels from one piece of computer equipment to another. The fibre optic cables used in the Project contain between 24 and 96 strands of glass per cable.

Dark fibre

‘Dark’ fibre refers to strands that are ready for use but have not yet been attached to lasers (i.e. unlit).

Broadband

Broadband is defined by Industry Canada's National Broadband Task Force as *“a high-capacity, two-way link that is capable of supporting full-motion, interactive video applications.”*

In comparison to traditional terms such as “narrowband” or “dial-up,” “broadband” is the modern term used when referencing access to the Internet. It is characterized as

- cable modem: broadband connection that brings information over ordinary television cable lines;
- digital subscriber line (DSL): broadband connection that brings information over ordinary copper telephone lines; or
- wireless broadband connection: information is sent from and arrives at a computer through transmission towers.

Broadband has a high speed, “always on” connection and two-way capability that can support many applications including professional, entertainment and consumer activities. Examples of users include:

- research, science and big business: large institutions and large businesses, particularly those doing research, require multiple gigabit circuits;
- small and home-based businesses: accessing corporate networks, email systems, and desktop video-conferencing;
- consumer activities: shopping, government online programs, research information, e-learning programs; and
- college campuses, hospitals and high schools.

Bandwidth

A key aspect of broadband is bandwidth which refers to the data transfer rate or how fast an amount of data can be carried from one point to another in a given period of time (usually a second). The following table demonstrates the speed associated with standard bandwidths.

Bandwidth

Speed	Description		Time to download 144 MB image file*
Kilobits per second (Kbps)	One thousand bits per second.	Most analog modems transmit at 56 Kbps or 28.8 Kbps	via 56 Kbps, about 348 minutes
Megabits (Mbps)	One million bits per second	6.0 Mbps is 200 times faster than a 28.8 Kbps analog modem	via 10 Mbps, about 3 minutes
Gigabits per second (Gbps)	One thousand million bits per second	6.0 Gbps is 1,000 times faster than 6.0 Mbps	via 1 Gbps, about 2 seconds
*Size of selected image files: CT Scan, 157 MB Ultrasound echocardiogram, 150 MB MRI: 45 MB; Mammography, 167 MB Source: Government of Newfoundland and Labrador			

Appendix D: Background - Broadband Strategy

National Broadband Task Force

In January 2001, the Minister of Industry for Canada announced the appointment of a National Broadband Task Force. Its mandate was to map out a strategy for achieving the goal of making high-speed broadband Internet services available to all Canadian communities.

In June 2001, the Task Force released “The New National Dream: Networking the Nation for Broadband Access.” The report concluded, among other things, that all Canadian communities should be linked to national broadband networks via high-capacity links. In addition, the report recommended that government-funded broadband deployment models should aim to achieve objectives such as:

- competitive and technological neutrality;
- transparency in all aspects of government funding programs;
- maximize the role and risk taking of the private sector; and
- encourage public and private sector partnerships.

Broadband for Rural and Northern Development (BRAND)

In September 2002, Industry Canada launched the Broadband for Rural and Northern Development (BRAND) Pilot Program which supported broadband funding under Infrastructure Canada.

Through the BRAND Pilot Program and the Canada Strategic Infrastructure Fund, the Government of Canada worked to:

- ensure complementary and effective delivery of broadband services to enable rural and remote communities access to e-learning and telehealth; and
- help small businesses in rural and remote areas obtain improved access to e-government and other online services.

These objectives were seen as crucial in helping to connect all Canadian communities to broadband Internet service. As at 27 March 2006 the National Broadband Pilot Program had reached almost 900 communities, including 142 First Nations reserves.

As of November 2006 investment in broadband in Newfoundland and Labrador totalled over \$21 million and benefited 161 individual communities throughout the Province.

Department officials indicated that no additional funding was available under this program.

**Connecting
Learners and
Communities
Broadband
(CLCB)
Initiative**

In June 2003, the Canadian Government, together with the Government of Newfoundland and Labrador announced a \$29 million “Connecting Learners and Communities Broadband (CLCB) Initiative.” The purpose of the CLCB Initiative was to expand high-speed broadband Internet access services offered by the Department of Education's Centre for Distance Learning and Innovation (CDLI). The funding (\$5 million Federal, \$5 million Provincial, and \$19 million Persona) will provide network access to 68 schools and 103 communities located in rural and remote regions of Newfoundland and Labrador.

The CLCB Initiative is ongoing and is scheduled to be completed by 31 March 2008. Departmental officials advised that, to date, Persona has exceeded its original investment of \$19 million by \$9 million, increasing the total project value to date to \$38 million.

**Blueprint for
the Future**

In 2003, prior to the Provincial election, the Progressive Conservative Party released its election policy document “A Blueprint for the Future” which outlined key commitments to the Province for the coming years. In terms of advancing the use of computing and high-speed digital networks in every region of the Province, the Party committed to initiatives such as:

- enhancing connectivity through upgrading of broadband infrastructure and other means, such as innovative combinations of satellite and wireless communications;
 - integrating the development of the IT sector in the Province with innovative approaches to social and economic development in such areas as e-business, telemedicine and distance education; and
 - improving relations with Federal agencies to ensure that Newfoundland and Labrador firms maximize their access to Federal funding and non-financial support programs for IT development.
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**Federal-
Provincial
Broadband
Strategy**

In February 2005, Industry Canada and the Atlantic Canada Opportunities Agency, in cooperation with the Department reported on a study they led entitled, “Setting the Context for a Federal-Provincial Broadband Strategy: The Current State of Broadband Data/Telecommunications Infrastructure in the Province of Newfoundland and Labrador.” The purpose of the study was to develop a comprehensive Federal/Provincial strategy for long-term broadband connectivity and strategic infrastructure development.

The report highlights the comparison of Newfoundland and Labrador with provinces across Canada, including that:

- Newfoundland and Labrador has the lowest level of financial commitment by Government and industry to provide broadband access to its citizens.
- In residential service, the Province is on par with other provinces.
- In institutional/business services, outside the Northeast Avalon, the Province is below the national average.
 - The Province currently has no research-level Wide Area Network (WAN) that extends to communities outside St. John's (as defined by speeds of 1 Gigabits per second or higher); and
 - Large institutions (e.g., Memorial University of Newfoundland and the College of the North Atlantic) and large businesses do not have the multiple Gigabit bandwidth that they require.
- The Province has a limited level of institutional activity networks (as defined by speeds of 10-100 Megabits per second). In research, MUN is ranked at the CANet*2 level, while post secondary institutions in all other provinces have access at the CANet*4 level.

The study also reported that communities believed that access to high speed networks was a main contributor to their sustainability and also noted that Internet Service Providers were reluctant to enter rural markets, which created a lack of competition in these areas.

The report recommended that the Government of Newfoundland and Labrador take a leadership role in ensuring that broadband access attains widespread availability. Government's role should:

- ensure that steps are taken to increase competition in the telecommunication market;
- be that of a model user in terms of aggregating its demand and continuing to increase its use of broadband networks for the services it delivers;
- facilitate and encourage market drive of the broadband network rollout in urban areas;
- foster awareness among people about the potential impacts of the applications of broadband in order to raise the level of understanding of the benefits of the technology and to promote its usage; and
- strive to ensure that businesses, institutions and residents in all communities have an opportunity to participate in and benefit from the broadband revolution.

**Government's
Broadband
Initiative (GBI)**

In April 2005, the Department of Innovation, Trade and Rural Development and the Office of the Chief Information Officer (OCIO) began a Government Broadband Initiative (GBI) to review all Government telecommunications requirements, with the intention of creating a Province-wide advanced computer network.

As the biggest user of broadband services in the Province, Government viewed an advanced network as vital for supporting innovative industries, expanding the research capabilities of educational institutions and allowing greater availability of such services as telehealth in remote areas. Sample projects to date have included:

- Telemedicine:
 - Real-time transmission of MRI images between health care centres;
 - Telecommunications connectivity between regional wide-area health networks;
 - Telehealth and Educational Resource Agency (TETRA) that delivers audio, video and web conferencing services.
- On-line education resources including supplementary instruction via distance in schools in remote communities;
- Real time remote manipulation of the undersea sensor data projects (MUN research); and
- Videoconferencing within the Justice system for court proceedings.

**Innovation
Strategy**

On 27 March 2006, the Department of Innovation, Trade and Rural Development released "Innovation Newfoundland and Labrador: A Blueprint for Prosperity."

In its discussion on information infrastructure, the Department noted that the current level of connectivity between the Province and the rest of Canada represented the lowest data transfer capacity within the country (622 Mbps versus 10 Gpbs). As a result, Newfoundland and Labrador's level of access into educational research networks is CANet*2; all other provinces are at CANet*4.

Although noted as a key challenge, improved broadband infrastructure for Government and for rural and northern areas would strengthen critical communications infrastructure.