2.30 xwave Contracts

Introduction

On 13 October 1994, Government announced the completion of negotiations for the sale of all the shares of Newfoundland and Labrador Computer Services Limited (NLCS) to NewTel Enterprises Limited (NewTel) and its consortium partners Bell SYGMA Inc. (Sygma) and Andersen Consulting (Andersen), representing 80%, 10% and 10% ownership respectively. NewTel and its consortium partners incorporated a new company called NewTel Information Solutions (NIS).

As a result of the privatization of Newfoundland and Labrador Computer Services Limited, Government entered into several legal agreements with NIS which set out the responsibilities of Government and NIS. The legal agreements covered the period 20 September 1994 to 31 March 2002 and set out commitments of both parties for each year. The Industrial Benefits Agreement outlined commitments related to targets for new information technology (IT) business to be brought to the Province by each of the consortium partners, new job creation and subcontracting of Government and non-Government work to other information technology providers in the Province. Government was also to have a representative on the Board of Directors of NIS.

Through the Service Level Agreement, Government and Memorial University of Newfoundland agreed to purchase $17.5 million in IT services annually during the term of the Agreement.

We completed a review of the privatization of NLCS in 1997 to determine whether all parties were in compliance with agreements, if Government was monitoring compliance, and whether Government had identified any performance indicators (other than those included in the agreements) to gauge the success of stimulating the IT industry by privatization of NLCS.

As a result of our 1997 review we concluded that some of the consortium partners had not met their investment and/or job creation obligations and that Government did not meet its commitment to purchase $17.5 million in services from NIS in the 1997 fiscal year. Neither party elected to apply legal remedies which were available under the agreements at the time of our review. We also concluded that Government had identified performance indicators to measure growth in the IT industry in the Province since 1994; however, information on these performance indicators had not been gathered.

Subsequent to our 1997 review, it became apparent that both parties, to differing degrees, had or would not comply with all provisions of the agreements. On 21 December 1998 both the Industrial Benefits Agreement and the Service Level Agreement were amended to address the areas of non-compliance by all parties. On 1 April 2001, a year before the expiry of the agreements, Government and xwave Solutions Inc. (xwave)

signed a new agreement to extend, amend and restate the Industrial Benefits Agreement. As part of the new agreement, Sygma, Anderson and NewTel would no longer be parties to the agreement and xwave would be recognized as the successor to NLCS. The new agreement released and discharged both parties from all obligations and remedies of the original agreements. Also, a new agreement was signed to extend, amend and restate the Service Level Agreement. The term of both agreements would be 1 April 2001 to 31 March 2007.

Treasury Board Secretariat of the Executive Council has been given responsibility for Government's obligations under the Amended Service Level Agreement and the Department of Innovation, Trade and Rural Development has been given responsibility for Government's obligations under the Amended Industrial Benefits Agreement and also for monitoring xwave's compliance with that Agreement.

Scope and Objectives

We completed our review of the Amended and Restated Service Level Agreement and the Amended and Restated Industrial Benefits Agreement in November 2004. The objectives of our review were to:

- determine whether all parties have complied with the agreements;
- review the process Government has in place to monitor compliance with the Industrial Benefits Agreement; and
- determine whether Government has identified performance indicators (other than those included in the Industrial Benefits Agreement) which would indicate whether the objectives of the privatization (e.g. stimulation of the local IT industry) have been met.

Conclusions

In 1994 Government privatized Newfoundland and Labrador Computer Services Limited and entered into several legal agreements with the new company. The agreements were to expire on 31 March 2002. Our review of the Service Level Agreement and the Industrial Benefits Agreement between Government and xwave Solutions Inc. identified a number of issues as follows:

- Although xwave did not meet its obligation to contract out $2,000,000 in work to local IT businesses for 2002, Government did not charge any liquidated damages as allowed in the Agreement.

- xwave did not meet its obligation to create 55 new jobs by 31 March 2004, and has indicated that it will not meet its overall employment commitments by 2007.

  Although there is a remedy under the Agreement to charge 15% of the dollar value of the shortfall in jobs in each year, which would represent $209,522 for 2003 and $204,649 for 2004, Government did not impose these liquidated damages. Instead, Government has negotiated a settlement for a single lump sum payment of $2.4 million which represents the liquidated damages resulting from xwave's employment shortfalls and discharges xwave from its employment creation commitments.

- Government is not monitoring the IT sector to determine progress towards its original goal of stimulating growth in innovative technologies and information industries in the Province by privatizing NLCS in 1994. In March 2002, Operation ONLINE ceased operation and therefore, no new work has been done to identify performance indicators or monitor growth in the IT sector.

Findings and Recommendations

On 1 April 2001, Government and xwave Solutions Inc. (xwave) signed a new Service Level Agreement and a new Industrial Benefits Agreement covering the period 1 April 2001 to 31 March 2007.

We reviewed the new agreements and found the following:

Service Level Agreement

Government's commitments to xwave are outlined in the Service Level Agreement. In return for xwave entering into the Industrial Benefits Agreement, Government has agreed to provide xwave with minimum annual revenue of $14,500,000 ($16,500,000 less the amount of up to $2,000,000 of services that Government is allowed to contract out directly to parties other than xwave or its affiliates).

If Government does not provide xwave with minimum annual revenue of $14,500,000, xwave may reduce its obligation to contract out other work to local IT businesses by the amount Government is short and xwave's job maintenance and creation obligations will terminate. In addition, Government will be required to pay xwave liquidated damages in the amount of 15% of the value of business short of the minimum annual requirement. Our review disclosed that Government has met and exceeded its obligations to purchase services from xwave under the Service Level Agreement.

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Industrial Benefits Agreement

Under the Industrial Benefits Agreement (the Agreement), xwave is required to submit annual reports to Treasury Board Secretariat outlining its performance against the requirements established in the Agreement. xwave has submitted annual reports outlining progress towards meeting the commitments in the Agreement for the years 2001, 2002 and 2003 as required; however, these reports have not been audited or verified by the Province.

Our review of compliance with the requirements of the Industrial Benefits Agreement indicated the following:

1. New Business

xwave must generate new business in the amount of $5,000,000 each year beginning 1 April 2001.

New business is defined as IT work that is made available to xwave by Aliant Inc. (Aliant Inc. is the parent company of xwave) and its affiliates and IT work generated by xwave itself for customers outside the Province. In both cases the work must be performed by employees of xwave who are residents of the Province. Projects that are specific to Aliant's operations in the Province are not eligible, new projects that are specific to Aliant's operations outside the Province are 100% eligible and new Aliant projects that apply to the Atlantic Canada region are 66% eligible.

Discussions with Department officials and reviews of reports from xwave indicated that this requirement was met.

2. Contracting out

xwave must contract out $2,000,000 in work, other than Government work, to local IT businesses each year beginning 1 April 2001 and xwave acknowledges that Government will contract up to $2,000,000 of Government work directly to parties other than xwave. In addition to this $2,000,000, xwave acknowledges that Government may contract out 30% of any amount in excess of an indexed threshold amount of IT professional services it purchases from xwave.

Any work xwave contracts out to local IT businesses that is not taken up by local IT businesses is included towards its $2,000,000 obligation.

xwave is also entitled to carry forward up to 30% of its $2,000,000 contracting out commitments to the following year, except the final year (2007), in the event it does not reach the $2,000,000 annual target.

xwave reported to Government that it was short $945,892 in the year ending 31 March 2002. It was entitled to carry forward $600,000; therefore, the actual shortfall relative to the contract was $345,892. Although, under the Agreement, Government could charge liquated damages at 10% of work not sub-contracted out, this option was not exercised. Instead, while not specifically provided for in the Agreement, Government permitted xwave to carry forward the $945,892 shortfall evenly to the 2003 and 2004 fiscal years after discussions with xwave in an effort to resolve the shortfall.

As a result of Government approving a carry forward of $472,946 to each of the 2003 and 2004 fiscal years, xwave was required to contract out $2,472,946 in 2003. xwave reported to Government that it only contracted out $1,900,805 in 2003 and was therefore short of its target by $572,141. As the Agreement entitles xwave to carry forward $600,000, the shortfall of $572,141 was carried forward to 2004 in addition to the $472,946 from 2002. The contracting out performance of xwave improved in the 2004 year when it completed all the work required and at the conclusion of 2004 had contracted an excess of $3,576 over its three year to date requirements.

3. New jobs creation

xwave is required to maintain its 2001 work force of 530 and to create 25 jobs in the first year of the agreement and 15 new jobs each year cumulatively (100 new jobs) for employees resident in the Province. The workforce and the new jobs exclude secretarial and clerical staff. The details are outlined in the following chart.

	Annual Jobs	Cumulative Jobs	Actual Jobs	Difference	Liquidated Damages
Opening Balance		530	530	-	$ -
2001-02	25	555	556	1	-
2001-03	15	570	527	(43)	209,522
2001-04	15	585	543	(42)	204,649
2001-05	15				
2001-06	15				
2001-07	15				
Total new jobs	**100**				

Source: Department of Innovation, Trade and Rural Development

As the chart shows, xwave has not met its employment targets for 2003 and 2004. Furthermore, xwave has advised Government that it is unlikely that it will achieve its overall employment creation commitment by the conclusion of the Agreement in 2007.

The remedy under the Agreement, as liquidated damages, if this employment creation commitment is not met is 15% of the dollar value of the shortfall in jobs in each year. This would represent $209,522 for 2003 and $204,649 for 2004.

However, officials indicated that Government was not pursuing this remedy and instead has negotiated with xwave for an overall amount for liquidated damages which removes the employment creation commitment from xwave. The Department of Innovation, Trade and Rural Development has calculated an amount of approximately $2.5 million as liquidated damages which, after a discount rate, will result in a $2.4 million settlement.

4. Inventory of Skills of Local IT Businesses

The Department of Innovation, Trade and Rural Development (the Department), in co-operation with xwave and representatives of the local IT businesses, is required to identify and maintain an inventory of the skills of local IT businesses. The reason for this is to facilitate xwave's obligation to subcontract $2,000,000 of work.

The Department informed us that the Newfoundland and Labrador Association of Technology Industries (NATI) maintains a database of skills and capabilities. The Department accesses the database when they require specific company information or verification of specific capabilities. In addition, in late 2002, xwave placed a full-time resource person at NATI's office to enhance their knowledge of local IT skills and capabilities.

5. Identification of Training Requirements

The Department, in cooperation with xwave and representatives of the local IT businesses, is required to establish a mechanism to jointly identify training requirements to optimize the growth in skills and maximize the opportunities to perform subcontracted work by the local IT industry.

The Department indicated the primary mechanism to identify training needs and training opportunities is again through NATI and the xwave resource located at NATI. The xwave resource works closely with NATI's staff and one-on-one with companies to identify training needs and to promote training courses. In addition, there are annual meetings held at

NATI's offices which involve senior Departmental officials, senior xwave management and local IT businesses. Finally, the Department and xwave management meet three or four times a year with NATI's President and Vice President to discuss the Agreement and performance to date and to identify training needs and opportunities among other things.

6. Access to training

xwave is required to make 15% of its space available for in-house training in methodologies, tools and technologies available to employees of local IT businesses at xwave's incremental cost.

The Department informed us that xwave completed limited in-house training in the year ended 31 March 2002 and little training was completed in either of the years ended 31 March 2003 or 31 March 2004. The global slowdown in the IT industry was cited as the reason for the limited training conducted, although the Department indicated one contractor did participate in three sessions at xwave. The availability of training seats to local IT businesses is dependent on xwave conducting in-house training and there are no remedies in the Agreement if xwave itself does not conduct training.

7. Software Availability

xwave has agreed, through best efforts, to make or arrange to make available to local IT businesses its software, programs, methodologies or tools if permitted by licensing or purchase arrangements. xwave has not reported any requests from local IT businesses in this regard.

8. xwave Contact Person

xwave must designate an employee to serve as a contact person for local IT businesses. xwave reports that it has assigned a contact person in each of the three years as required by the Agreement.

9. Development of IT Expertise

xwave covenants it will co-operate with Government in the development of IT expertise within post-secondary institutions. A review of the three annual reports which report on the Industrial Benefits Agreement by xwave indicates that most activities involve the hiring of work term placements from post-secondary institutions. Other activities included participation in IT program accreditation and attendance at career fairs.

The Department informed us that Government has no formal mechanism to initiate development of IT expertise in post-secondary schools; however, NATI does play a role through its contacts with the Department of Education.

10. Headquarters

xwave is required to maintain its registered office (headquarters) in St. John's. None of the three annual reports which report on the Industrial Benefits Agreement by xwave addressed this issue. The Department's assessment of compliance with the Agreement indicates in the 2003 fiscal year the registered office remained in St. John's; however, the duties of the Vice-President of the Newfoundland and Labrador Business Unit was planned to be reassigned to New Brunswick. At the end of the 2004 fiscal year the Department concluded that, while the registered office as defined by a mailing address remained in St. John's, the executive offices are generally recognized to be outside of the Province. As a result, in our opinion, xwave is not in compliance with the spirit of the Agreement.

11. Data Centre Consolidation

The Agreement indicates that xwave will, after 31 December 2001, perform all Aliant Telecom Inc. Atlantic Canada mainframe processing in the Province and upgrade specified hardware. xwave reported in its 2003-2004 annual report that it had invested in excess of $10 million in improvements in its mainframe technology. The report does not address whether xwave is performing all Aliant's mainframe processing; however, the Department indicates xwave is meeting its commitment in this regard.

Remediation Plan

As a result of xwave's inability to meet job creation targets and issues with subcontracting commitments in 2002 and 2003, Government requested that the company, in consultation with NATI, develop a remediation plan to address these issues. The plan which was completed by xwave and accepted by Government in March 2003, was intended to supplement the 2001 Industrial Benefits Agreement. The major elements of the plan are outlined as follows.

1. Client Support Centre

The IT Client Support Centre (CSC) serves xwave's major clients in Canada, the United States of America and Ireland. xwave will expand the CSC in St. John's by creating 33 new positions, 23 of whom shall be xwave employees and 10 of whom shall be subcontractors from local IT businesses. In addition, xwave undertook to expand the CSC at a cost of

$1.2 million. xwave indicated it would complete the hiring by 31 March 2003 if the remediation plan was accepted by Government.

The Department informed us xwave has moved the CSC to Newfoundland and Labrador from New Brunswick and hired the 33 (23 staff positions and 10 contractual positions) positions it committed to in the 3 March 2003 Remediation Plan. This was verified by a site visit by Departmental officials.

2. Job Growth Shortfall

xwave reported for the year ended 31 March 2003 that as of January 2003; it was 63 jobs short of its new job creation obligations. The remediation plan would fully address this job creation shortfall by hiring, in addition to the 23 CSC employees, an additional 10 employees by 31 March 2003 and a further 30 by 31 October 2003. While the plan addressed the job creation shortfall, xwave acknowledged that the offer does not limit Government's right to apply financial penalties that exist in the Agreement.

The job shortfall was reduced between January 2003 and 31 March 2003; however, at 31 March 2003 xwave was still 43 jobs short of its new job creation obligations. The planned job creation remediation did not materialize in 2003-04 and xwave was still short 42 jobs at 31 March 2004.

3. New Business

xwave would give first consideration to Newfoundland and Labrador as the location for new business operations and/or new jobs as new business would be secured. The Department informed us, to the best of their knowledge, there have not been any new jobs created in other provinces by xwave at the detriment of employment in this Province.

4. Near Shore Development Task Force

Aliant, the parent of xwave, would support the creation of a Near Shore Development Task Force. This Task Force would be headed by Government, and Aliant would commit leadership and financial resources valued at $250,000 per year over a three year period. The “near shore” concept is a current trend in the IT marketplace which is focused on software development for American and European companies designed to replace “off shore” (meaning Asian and East European countries) due to increased economic and political instability.

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On 6 March 2003 Government announced, through a press release, that it had accepted the Remediation Plan. An agreement with Aliant was signed on 31 May 2004 and a Task Force has been formed. The Task Force consists of two Government representatives, two Aliant or xwave representatives and one representative from the Newfoundland and Labrador Association of Technology Industries (NATI).

A strategic plan has been developed and interviews have been conducted to staff the Task Force. At the time of our review the Department expected the initiative to be formally launched in the near future and indicates the office would be housed in office space adjacent to NATI.

Monitoring the IT Industry

When Government privatized NLCS in 1994, it indicated that the goal was to stimulate growth in innovative technologies and information industries in the Province.

In our 1997 report we reported Government was monitoring the extent of stimulation of the IT sector through its involvement with Operation ONLINE. Operation ONLINE was a non-profit corporation representing a partnership of industry with the Federal and Provincial governments. Operation ONLINE had identified approximately 40 performance indicators in 1997 to measure growth in the IT sector.

The Department informed us that since Operation ONLINE ceased operation in March 2002 there has been no new work done to identify performance indicators or monitor growth in the IT sector. The Department does not have the budget or the human resources to continue the work started by Operation ONLINE and it has relied on NATI and other sources such as Statistics Canada for information and statistics on the sector.

As a result, Government does not know the extent to which its original goal of stimulating growth in innovative technologies and information industries in the Province has been met.

Treasury Board Secretariat's Response

The Treasury Board Secretariat, through the Information Technology Division, closely monitors adherence to the Service Level Agreement. The Secretariat is therefore pleased with the Auditor General's findings that Government has met or exceeded its obligations under this Agreement.

Department's Response

Since extending the xwave contract in 2001, the global IT sector has and continues to experience a significant slowdown in business. This downturn has had a major impact on both xwave and the local industry. The negotiated amendment to the IBA will send a strong signal to local industry that government has recognized the difficulties that the local industry is experiencing, and that government has taken proactive steps to help grow the local IT sector.

Government will use the negotiated payment in lieu of the liquidated damages, to establish an IT investment fund. This fund will help strengthen the provincial IT sector and help position local businesses to maximize future business opportunities. Establishing a fund at this time, rather than simply waiting to collect the liquidated damages as they become due, is a more proactive way of addressing the current reality.

The Department of Innovation, Trade and Rural Development will continue to closely monitor the xwave Industrial Benefits Agreement.

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