

CONFIDENTIAL - COMMERCIAL**PRIME MINISTER****HORIZON (BA/POCL AUTOMATION)*****Issue***

Whether to proceed with an alternative approach to the Horizon project, which has emerged in discussions between Treasury officials and ICL.

Recommendation

There are potentially greater risks, and possibly additional costs, in pursuing this new approach than if we continued with the Benefit Payment Card (BPC). It would also almost certainly mean that the Post Office White Paper would have to be delayed. But on balance, we believe this new approach fits better with the Government's objectives (as set out in Alan's minute of 25 January), and by improving the incentives on BA and POCL offers a better chance of delivering a successful outcome. And, assuming the price and conditions are agreeable, we are keen to proceed with the new option. Both Alistair Darling and Stephen Byers have written with their support in principle for the new approach.

Action

If you agree we should take this approach forward, Steve Robson (HMT), in conjunction with officials from DTI and DSS, should work with BA and POCL to develop a detailed specification and negotiating remit, before opening discussions

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with ICL. But it would help the handling with the Post Office if you were prepared to speak to the Chairman or Chief Executive to let them know of the Government's decision and make clear the Government's commitment to the new option.

Timing

Immediate, so that negotiations can begin with ICL as soon as possible.

Background

You agreed (Jeremy Heywood's letter of 28 January) that Treasury officials should explore with ICL the options for achieving the Government's objectives for this project with or without a Benefit Payment Card (BPC).

2. The new approach which emerged from these discussions is set out in detail at Annex A. It would involve dropping the BPC and moving more quickly to payment of benefits by ACT. However, it would also seek to maintain footfall revenue for the Post Office, since those benefit recipients who currently receive their benefits via order books would have their benefits paid into simple credit-only "benefit accounts" run by POCL, using the BACS clearing system, and only accessible at post offices via a smartcard.

3. It would, as now, be open to any benefit recipient to opt for payment of benefits by ACT into a conventional bank account (and eighty per cent of benefit recipients already have access to a bank account). However, we believe that a significant proportion of benefit recipients will continue to receive their benefits at post offices - either because they are amongst the twenty per cent who do not already have a bank account, or because the local post office is more convenient for them, or just because of inertia. This means that the Post Office should retain a similar level of footfall as under the BPC. It also ensures that the smartcard has

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a large initial circulation, which will help the marketing of smartcard-based services.

Assessment

4. We have looked at the costs and the risks attached to this new approach compared with the BPC (see Annex B), with the help of KPMG.

5. On the costs, the initial modelling showed that the BPC appeared to offer better value for money than the new approach. There are factors which could narrow this gap. In particular, KPMG took a cautious view of the impact of the new approach on Post Office footfall revenue. They also pointed out that the costings were highly dependant on the timetable - the value for money gap would be narrowed further if it were possible for DSS to accelerate the start of payments by ACT, provided POCL had by then installed the infrastructure necessary to support post office benefit accounts.

6. However, there are risks from pursuing the new approach which could increase the costs:

- ICL may view the change in the project specification as an opportunity to try to recoup from the public sector a significant proportion of the development costs already sunk in the BPC (perhaps of the order of £250 million), and in addition the costs of the new development work that would be needed to meet the requirements of the new approach;
- there is the risk associated with developing a new infrastructure to support the post office benefit accounts;
- potentially greater fraud risk borne by the public sector. Under the BPC,

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up to £200 million of the fraud risk (eg from stolen cards) was to have been borne by ICL. It is likely that ICL will argue that under the alternative approach, because it will be POCL who would be issuing the cards to holders of post office benefit accounts, it should be the Post Office that bears this risk;

- given the fundamental changes that this new approach will require to the original contractual basis, there are difficult issues relating to EU procurement law which would need to be addressed, and a risk of judicial challenge.

7. On the other hand, the new approach would provide better incentives for the parties (BA, POCL and ICL) to act together, which would have implications for the overall success of the project. It would take BA out of the contract altogether - their focus would instead be on getting their own systems ready for ACT. For POCL, it provides the infrastructure necessary to help build a business as the supplier of community financial services. Above all, it offers the best chance of delivering this project successfully, since the two remaining parties to the contract (POCL and ICL) will have every incentive to see the Horizon infrastructure in place as soon as possible.

8. More generally, the new approach should also provide a boost to wider Government objectives, by bringing on stream more quickly a widely available smartcard for the delivery of modern government services, and combatting financial exclusion by providing simple bank accounts to all benefit recipients.

9. On balance, we therefore believe that this new approach is worth pursuing. Alistair Darling and Stephen Byers have both written with their support in principle. However, Stephen is concerned that taking forward this new approach will delay the Horizon project. His agreement is on condition that we can keep the

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BPC option on the table as a fallback as we take forward work on the new approach.

Way forward

10. So far, the specification and costing of this new approach have been carried out solely within the Treasury with the assistance of KPMG. The Benefits Agency and Post Office have not yet been involved. If we are to take it forward, we must involve them as soon as possible. And we also need to tell ICL that Ministers would like to take this approach forward.

11. The most difficult handling issue involves the Post Office, particularly in the wake of the announcement in December that they would be given greater commercial freedoms. Their Board have already approved the BPC under the contractual terms offered by ICL before Christmas, so they may feel that they are now being overruled on a commercial decision. It will be important to make clear to senior Post Office management that there are Government-wide reasons why this approach is preferable to the BPC, and it would help to reinforce this point if you were able to give this message to the Post Office Chairman or Chief Executive personally. In addition, if the Post Office are to work seriously on this new approach, it would be important to make clear to them that the Government's firm decision is in favour of the new approach rather than the BPC.

12. Once BA and POCL have been informed, the next stage would be to draw up with them a detailed specification for the new project and a negotiating remit. While the detailed negotiations with ICL would have to be taken forward by POCL and BA, we suggest that DSS and DTI officials, under the chairmanship of Steve Robson (HMT), should oversee and direct the process. In addition (not least to maintain our negotiating leverage, as well as to meet Stephen's concerns) it would be vital to keep in play with ICL the options of proceeding with the BPC and of

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abandoning the Horizon project altogether.

13. However, the main urgency is that senior management at ICL are keen to hear from us whether we want to pursue this new approach. We would like to be able to give them an indication within the next day or two. We would therefore be grateful for your approval to take matters forward in this way.

Post Office White Paper

14. If we go down this route, we would need to decide on the implications for the content and timing of the White Paper. It would play into the hands of ICL's negotiators if we were to announce our new approach on Horizon before we have reached heads of agreement. And while we would aim to get to this stage as quickly as possible, realistically it would not be until after Easter.

15. One option would be to delay the White Paper. However, although Stephen believes that ideally the White Paper needs to be as clear and positive as possible on the future of Horizon, we understand that he does not believe it would be right to delay the White Paper on account of the project.

16. An alternative would therefore be for a much shorter and more guarded chapter on the POCL business than is currently envisaged. However, Horizon is a vital element of POCL's future strategy and a lack of clarity on the project may raise difficult handling issues, not least with sub-postmasters. Given this, it may therefore be better to delay the White Paper.

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17. Copies of this minute go to Alistair Darling and Stephen Byers, and to Sir Richard Wilson.

GRO

ALAN MILBURN

GRO

CHARLES FALCONER

24 February 1999