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To:

MR MCCARTNEY

From:

DAVID SIBBICK

Director Posts

BPR GRO

GRO

cc Secretary of State
Mr Scholar
Mr Macdonald
Mr Baker CGBPS
Mr Macintyre CII
Mr Fraser IBB
Mr Wheeler IMT
Mr Sklaroff COM
Mrs Britton PORT
Mr Osborne LegalC
Mr Hosker FRM
Dr Hopkins CII
Mr Whitehead CGBPS
Ms Anderson CGBPS
Mr Corry SpAdv
Mr Wegg Prosser SpAdv

13 November 1998

BA/POCL COUNTERS AUTOMATION PROJECT: HORIZON

Issue

A progress report from the Treasury-led interdepartmental Horizon Working Group (HWG) in preparation for your meeting with colleagues next Tuesday evening (17 November) on the future of the Horizon project.

Recommendation

2. To note. The report remains to be finalised (we have contributed to and commented extensively on a succession of earlier drafts), though we would not expect significant changes at this stage. We will submit a final version together with suggested lines to take on Monday before our briefing meeting with you.

Timing

3. Weekend reading in preparation for Tuesday's meeting with colleagues (and Monday's briefing with officials).

BACKGROUND

4. My submission of 6 November (copy attached for convenience) set out the progress then achieved in the negotiations with ICL to try to find a commercially acceptable basis for continuing with the project.

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5. Since then - essentially over the course of last weekend - ICL and POCL have signed Heads of Agreement on a partnership arrangement, and ICL have come forward with a complex set of proposals for extensively reworking their contractual basis with the public sector side. Keith Todd and John Roberts wrote to the Chief Secretary on 9 and 10 November (copies attached) respectively reporting from the perspective of each the progress made, and arguing that this had been sufficient to justify a further period to try to reach agreement on the remaining issues.

6. The draft report analyses the Heads of Agreement and the further proposals from ICL, and attempts to draw conclusions. On the primary question of whether sufficient progress toward bridging the gap left at the end of the "Corbett" round of negotiations has been achieved to justify a decision to continue with the project, the answer is unequivocally "no". On the secondary question of whether sufficient progress has been made to justify a decision to allow yet more time for further negotiation, the DTI/POCL view is "yes", the DSS/BA view is "no", and the Treasury view is perhaps best summed up as "probably".

Progress

7. In the partnership discussions ICL in the end dropped their demands for a share in the control of POCL's commercial destiny through structural arrangements, cross-shareholdings etc. They also greatly moderated their demands around "preferred IT supplier" status. These were major concessions on ICL's part, since they had been holding out strongly for arrangements in each case which were firm enough to be "bankable". They were the concessions which enabled Heads of Agreement to be signed, and which in turn has enabled new business (code named "Golden Cloud") with an NPV of perhaps £100m to be added to the pot.

Still outstanding

8. ICL have effectively made no move towards bridging the financial gap between the two sides (the claim in Keith Todd's letter that ICL are now willing to underwrite up to £100m of the gap is a transparent "smoke and mirrors" illusion, since he knows that on reasonable assumptions this amount will be covered - and perhaps much more than covered - by the new business from Golden Cloud). On the contrary, ICL expects the public sector side to pump in a further £121m (primarily through price hikes within the contracts), together with an additional £50m up-front contingency payment (returnable later if not needed). In a whole series of ways the contracts would be restructured in ways that transfer risk back to the public sector (and in so doing help ICL with access to limited recourse funding). A major area of controversy concerns proposals to soften the criteria for acceptance. A further element of the proposals envisages that after acceptance, POCL would in

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effect take over the BA contract with ICL. Whilst offering a welcome simplification from the prevailing uneasy tripartite relationship, there would be major concerns about POCL's (and therefore DTT's) potential liabilities under such an arrangement.

9. As the report makes clear, there is still a long way to go to reach a deal which would be acceptable to the public sector side. As we see it, however, the progress made last weekend now gives grounds for hope that a further push could cause ICL to make the significant move towards bridging the financial gap between the two sides for which we have all been waiting., though it is clear that there would almost certainly be a need for further input at that stage from the public sector side, perhaps on the lines of the ideas for asset purchase floated (though not to ICL) earlier by the Post Office.

DAVID SIBBICK