

RESTRICTED - POLICY

RWA/1/05.

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ci: PS/Secretary of State
Sir Michael Scholar
Mr Macdonald

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1 July 1999

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1. Mr Faulk
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HORIZON WORKING GROUP: STEERING BRIEF FOR 3RD MEETING 7 JULY 1999

PO / ICL NEGOTIATIONS

1. A report by the Post Office on its negotiations with ICL is at Annex A. The story here is that they have made good progress. On the **timetable for roll-out**, there has been some re-ordering to take account of developments and in particular with the difficulties with the Wednesday cash balances, but the new timetable remains firmly focused on achieving the completion of roll-out by March 2001, to which both sides remain firmly committed.
2. On **spare capacity**, the Post Office have now accepted that they cannot deal with this as a contractual issue and are now in discussion with ICL and are hopeful that they will arrive at a position where there is a clear understanding between the two sides on the amount of spare capacity on the system that exists and is available for POCL's use without incremental increases in cost. The Working Group need only take note at this stage, but the issue may need to be revisited if the discussions fail to produce an outcome which POCL believe to be reasonable in the circumstances.
3. **Acceptance testing**. Here again, POCL believe they have reached an accommodation with ICL, but will report back further if problems arise.

POCL / BA NEGOTIATIONS

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4. The Post Office report is at Annex B. The position here is both more complex and less satisfactory. On **OBCS**, under the benefit payment card contract BA were to pay POCL 0.9p per transaction and pay ICL 4p-5.5p per transaction (according to the complexity of the transaction) for use of the system. POCL have proposed that BA should instead pay a rate of 1.25p per transaction to them (there would of course be no direct payment to ICL) but that there should, in addition, be a flat rate payment of £13 million per quarter over the life of the contract - uprated periodically by the RPI - and equivalent to a fixed charge of £300 million over the life of the contract. The net effect of these changes would be to add £200 million to BA's bill. In addition POCL are insisting that the "floor" or minimum guaranteed payment, should remain in force between 2003 and 2005 at a potential cost to BA of £200 million.

5. I have discussed this with BA, who regard POCL's claims as "wholly unreasonable", as well as far exceeding the negotiating envelope agreed by Alistair Darling on the basis of KPMG's costings of option B3. BA are, however, willing to recycle the £113 million saved by not paying a 4p-5.5p charge per transaction to ICL. This would enable BA to increase the OBCS payment from the present 0.9p per transaction to around 5p (but with no fixed payment). They are probably also willing, in practice, to agree both that the existing floor payment should continue until 2003, and that some form of new floor should be negotiated to cover the years 2003 - 2005, provided that it is related to the expected volumes of business in each of those years, once their plans for migration have been firmed up and agreed with their Ministers.

6. On **risk transfer** there appear to be two elements. The first relates to faults which can clearly be laid at the door of POCL and its staff - for example overpaying a benefit recipient or ignoring an OBCS stop notice. There is no dispute between the two sides on how this risk should be dealt with and paid for. The second element relates to faults or weaknesses which can be attributed to the system. These include equipment failure, fraudulent hacking into the system, etc. Under the benefit payment card contract, BA could seek to recover up to £200 million over the life of the contract from POCL who could, in turn, pass this cost on to ICL. POCL claim that under the new arrangements they are unable to offload this cost onto ICL, and that BA should carry the risk itself. BA dispute this, and say that there is provision in the new contract between POCL and ICL for claiming against such failures up to a maximum of £200 million, and they are therefore seeking no more than to perpetuate what had been agreed under the bpc arrangements. We will try to clarify this one way or the other before your meeting next week.

7. Finally, on **acceptance testing** POCL claim that since the only contractual relationship with ICL is theirs, there is no basis for BA to demand acceptance testing. They claim in particular that the criteria proposed by BA would risk delaying overall acceptance of the system and completion of national roll-out by March 2001. The

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Benefits Agency tell me that they have now reconsidered POCL's objections. They insist that they will not enter into a contract worth £130 million with POCL without adequate safeguards that the system will work properly in practice. However, they are willing to modify their demands so that the acceptance criteria they will require to be met by POCL match exactly the acceptance criteria which POCL have agreed with ICL. The Post Office, this afternoon, acknowledged that they had received a revised offer from BA on this basis which they have yet to consider. We will report further before your meeting next week.

Comment

8. These reports represent continuing work in progress, and the Post Office say specifically in their letter that they are not looking to you to take up the detailed negotiation on any of these points on their behalf. What they would like is for you to use your good offices with Alistair Darling to persuade him to loosen the funding envelope of £113 million to enable a more generous level of payment for OBCS to be made either in the form of a higher per transaction payment, or in the form of a fixed quarterly payment towards to the overall cost of the network. Frankly, a general exhortation to be a bit nicer to POCL is unlikely to cut much ice. Nevertheless it is clear that there is scope for BA to go a little further by sharing with POCL some of the projected £100 million savings which OBCS is expected to produce. If no further progress towards an acceptable compromise has been reached by the beginning of next week, we will provide a draft letter for you to send to Alistair Darling with a specific proposal to use part of the projected £100 million savings to provide BA with greater negotiating flexibility on the price for OBCS.

LONGER-TERM FUNDING OF THE COUNTERS NETWORK

9. You undertook to report back on progress towards establishing an interdepartmental study of POCL funding issues. We will let you have a note early next week when we are clearer on how the proposal that the Performance and Innovation Unit should be the vehicle for such a study is being taken forward.