



Briefing for Meeting

Alisdair Cameron

Chief Financial Officer at Post Office

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Background

This document has been produced as a briefing for the meeting between Alisdair Cameron CFO, Post Office and Michael Keegan and Steve Clayton of Fujitsu, scheduled for 9 a.m on Wednesday 20th May. This meeting is one day ahead of the Post Office main board meeting which is scheduled for the 21st May. The status of R&R2/TSS2 and HomePhone and Broadband is included in this briefing but no further information on settlement due to its legally privileged nature.

We have been told that R&R/TSS2 will be formally presented at this board meeting as the ramp down (insurance policy) for the IBM Front Office ramp up plan which has been designed to replace the current Horizon platform. The board will also be informed of the Post Office's Telecommunications team's intention to extend the current HomePhone and Broadband contract by a further 3 years with Fujitsu and that this is currently subject to the resolution of a few outstanding issues – they have briefed Alisdair that they expect these issues to take two weeks to fully resolve. The jointly agreed plan is to sign both contracts and the settlement agreement which will settle all outstanding claims between the parties in June.

On the 23rd March, you met Alisdair Cameron at Post Office's new offices at Finsbury Dials. At that point he informed us that we wanted to link the 4 transactions (R&R2, TSS2, HomePhone and Broadband extension and settlement) and that we should work to ensure the Post Office board was in a position to approve them on the 21st. Since that point the Post Office and Fujitsu deal and legal/commercial teams have been working towards this common goal.

Status of the deals

R&R2/TSS2

We have made an offer capable of acceptance on TSS2 to extend the existing TSS for 12 months from March 2017 to March 2018. The TCV is £32.8m and the margin is 36.7% (blended). Subject to final drafting (currently being reviewed by CMS Post Office external lawyers) there are no outstanding commercial issues. The contract will be executed under a contract change note (CCN1500).

We have provide a ROM for R&R2 (technology refresh of the components not covered under the original R&R which come out of support before March 18). The ROM TCV for this project is £24.7m at a blended margin of 26% (project starting in August and running for 19 months). This refresh is necessary for two key reasons;

1. Provide the same level of service (at the same level of risk) as today for the business services that Post Office provide to the market today. We have analyzed the business platforms which provide these services and the necessary underlying components; refreshing only what is absolutely necessary.

2. Maintaining PCI compliance; approximately £13m of the £25m would be required in any event for this (Windows 2003 and Redhat upgrades) and without it Post Office would be unable to achieve compliance and strictly speaking unable to continue trading without it.

TSS2 is subject to Post Office completing the work under R&R2. The impact if R&R2 is not signed is that the TSS2 CCN falls away as if it had not been signed – this is clearly important in the context of our desire to link the signature of all the transactions together. The Fujitsu deal team is currently working on converting the R&R2 ROM into an offer capable of acceptance and we plan to have this work completed by the end of first week of June.

Given that Alisdair mentioned it in his note to you which followed your meeting on the 23rd March it should be noted that we offered an incentive scheme to jointly work towards an early termination of TSS2 (in the absence of any proposals from Post Office) and their deal team have decided not to proceed with one or build one into the contract.

HomePhone and Broadband

On Friday, 15th May we had three material outstanding commercial issues as outlined below. We met on Monday and agreed positions on these which have been agree subject to drafting (which we will be sending to Post Office today) and subsequent approval by Martin George, Commercial Director, Post Office and Alisdair Cameron. Alisdair should have been briefed on these specifics ahead of your meeting with him.

Issue 1: Exclusivity

Fujitsu requirement:

Sole and exclusive status for the full service so that Post Office, or any acquiring business, cannot cherry pick higher margin parts of service. Fujitsu has provided a price for an end to end managed service where clearly some parts of the service will have a higher margin than the telco pass through.

Post Office response:

The terminology 'sole and exclusive' is problematic for Post Office's lawyers so the deal team has suggested that Fujitsu list all of the suppliers or services which cannot be removed from the managed service, precluding a 'sole and exclusive' definition

Way forward:

Both parties have agreed that Post Office can identify different suppliers or services as long as that change is controlled and impact assessed (under the existing contractual Change Control Procedure) and that Fujitsu's margin is not compromised in % terms. The principles are agreed and we will work with Post Office's lawyers this week to incorporate the most appropriate wording. Fujitsu's remedy for Post Office breaching the exclusivity provisions will be loss of profits capped at £4.5m (across the Service Lines) in total

Issue 2: Termination for Convenience

The current contract allows for termination for convenience. The figure started at £21m when we originally signed the deal (to recover sunk costs), and tapers down to £2.6m in 2017 when the existing deal expires. The Fujitsu requirement is for an inflated T for C charge (£4.5m across the Service Lines) which starts at 2017 and remains for the duration of the new deal. This figure constitutes a loss of profit.

In the event that Post Office sell the business, Fujitsu requires an additional 12 months of service over and above the contracted minimum 6 months exit period = 18 months in total. This is in addition to the termination for convenience charge of £4.5m if the acquiring business brings the services in house.

This point is agreed by the deal teams and has been brought into Post Office for approval

Issue 3: Change in Material Subcontractor

Fujitsu requirement:

1. Fujitsu requires the ability to change a material subcontractor (TalkTalk, MDS or HGS) in the event that the supplier is under performing. If Post Office veto that right, Fujitsu secures relief on the affected service obligations, including service levels and service credits.
2. For any other reason, Fujitsu can change a material sub-contractor without Post Office permission or authorisation subject to a number of qualification criteria eg financial standing but Fujitsu will provide surety of up to £20m for loss of profits due to the reduction in the number of subscribers directly attributable to the change in the subcontractor. This will be time bound, directly attributable and justifiable by Post Office.

We are encouraged by the response of the deal team in relation to this point but that and the above other two points are subject to Post Office governance.

Conclusion

R&R2/TSS2 and HomePhone and Broadband are now both in a position where subject to Post Office governance and final drafting signature will be possible during June.

However, we have encountered situations previously where the Post Office deal teams and senior executives are not fully aligned and expectations have had to be re-aligned accordingly. Therefore, your meeting on Wednesday morning has the following objectives:

1. To understand if Alisdair has been fully briefed at this juncture
2. Verify if he shares our view that his teams have expressed that there are no outstanding issues (pending approval of the HomePhone and Broadband fixes that have been proposed above)
3. Determine if there are any other blockers which he wishes to raise
4. Verify exactly what he is seeking approval for at the Post Office board on the 21st

5. Re-state our position that all 3 transactions must be effectively executed at the same time (as per your previous response to his note)
6. Verify that these transactions can be fully completed this quarter

I do not propose that you raise the value of the settlement and our position on this will be as outlined in the settlement agreement that will accompany the HomePhone and Broadband extension materials. Should he expressly raise it and its value then we should state our position as discussed yesterday evening.

As ever should you have any questions or queries ahead of the meeting then please do not hesitate to raise them with me directly.