

**Personal & In Strictest Confidence**

POB(99)4th

**POST OFFICE BOARD**

**SEPARATE RECORD OF PROCEEDINGS**

**PO99/43**

**CHAIRMAN'S  
BUSINESS**

- (v) The future of the Horizon programme remained uncertain. Two options for its continuation had been developed. Option A would result in the continuation of the programme on the terms agreed with ICL in December 1998, with the benefit payment card being retained but compulsory Automated Credit Transfer (ACT) being introduced from 2005. This had not been agreed with the Benefits Agency. Option B envisaged the programme continuing but without the benefits card. POCL would in effect become a bank, offering basic accounts accessed through a Post Office smartcard. Existing post office benefit customers would have to transfer to the new account between July 2002 and June 2004. ICL would also be compensated for the abortive work carried out under Option A. This would consist of £50m aborted costs, £30m for sub-contractors' costs and £100m for cash flow delays. Funding of compensation had not been discussed but POCL would expect it to be met by Treasury or DSS.
- (vii) Neither Treasury nor DSS/BA supported Option A, so Option B (or termination) was the only real way forward. Under this option a Heads of Agreement was being developed and Fujitsu, ICL's parent company was, because of disclosure implications within its report and accounts, pressing for the document to be signed by 10 May 1999, the date on which its accounts had to be finalised. POCL still had a number of concerns which at this stage prevented the Head of Agreement from being signed.
- (viii) Government were keen to avoid termination - mainly because of the likely impact on ICL and high litigation risks. Under any termination option POCL would not want to move to compulsory ACT before 2005, although DSS/BA would seek its introduction from 2001. Termination would also pose a real threat to the sustainability of the network. In the meantime, POCL had developed a contingency plan for the short term provision of service and the procurement of a replacement system.
- (ix) Financially Option A remained by far the best solution for POCL with a positive NPV of £315m. Termination, but with the existing DSS contract continuing as now until 2005, produced a negative NPV of £(515)m and termination without a long term DSS contract resulted in a negative NPV of £(799)m. Option B had a negative NPV

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of £(888)m. The termination options made no allowance for the costs that may be necessary to re-shape the network of post offices. All POCL NPVs were based on a discount rate of 12%.

- (x) KPMG had been employed by Government to carry out a value for money report and had based its financial analysis on a discount rate of 6%. They had produced quite different absolute results, although the relativities of the options remained the same. For POCL Option A was seen as having a positive NPV of £179m, Option B a negative NPV of £(966)m and to terminate had a negative NPV of £(943)m. ICL are shown as having a negative NPV of £(439)m under Option B which they would not be prepared to accept, and would therefore seek to off-set their position through charges to POCL. This would therefore result in a negative NPV for POCL of £(1.4)bn or over £(1.5)bn worse than Option A. Only BA returned a positive NPV with figures ranging from £1,123m for Option A to £2,087m for termination. KPMG had also produced a combined NPV known as the 'Public sector total'. Under Option A this produced a positive NPV of £1,266m, Option B a NPV of £399m and under termination an NPV of £994m.
- (xi) A profile of the cumulative funding requirement under Option B showed that breakeven would only be achieved in 2008/09 and that at its peak in 2003/04 funding would reach £850m.
- (xii) Although Option A was the best option for POCL and provided the best value for money for the public sector. Ministers felt it could not be delivered and were unlikely to pursue it. Option B was a high cost, high risk option for POCL and currently was not a commercially viable proposition. Termination remained an option although it was also high risk and high cost.
- (xiii) If the project were to be terminated, POCL would need to seek assurances from Government over speed of ACT migration and impact on the network.  
  
noted further that
- (xiv) The Chairman and Chief Executive were due to meet Stephen Byers, the Secretary of State at the DTI, on 28 April to discuss Horizon. In advance of this meeting the Chairman would write clearly setting out the view of The Post Office Board and in particular the essential requirements for Option B to be progressed. These would include a commercial case that with a balanced risk profile, funding for the programme being provided without detrimentally affecting other planned Post Office activities, and the impact and timing of the costs on The Post Office and POCL's profit & loss account.

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- (xv) The Government had published a White Paper on 'Modernising Government' and this included a commitment to an automated Counters network. It was estimated that through automation of Government services, a potential revenue stream of between £2.5bn and £4.5bn could be released which, if provided to POCL, would offset the revenue lost under progressing Horizon. A commitment from Government to release a stream of revenue as a consequence of 'Modernising Government' would be sought.
- (xvi) The BA benefited financially through Option B as a result of only having to pay the cost of transferring funds by BACS into the Post Office account. They had, however, assumed that the High Street banks would be willing to handle accounts for up to 19m individuals the vast majority of whom would be low earners who would withdraw all funds soon after the account was credited.
- (xvii) DTI remained allied to The Post Office's recommended solution but were isolated within Government. The difficulties experienced with Horizon were not expected to impact negatively on POCL's Government Gateway aspirations.
- (xvii) To date reactive briefing had been prepared to deal with media enquiries but contingency arrangements had been prepared to deal with potential leaks. Members would be provided with some historical briefing to assist with any external enquiries they might face.
- (xviii) The potential impact on the network would not at this be set out formally to Government.
- (xix) Whilst the Board could refuse to accept an uncommercial proposal it remained within the power of the Secretary of State to direct The Post Office to proceed. This had never happened before and the Board would want to continue to work constructively with all parties to try and avoid this damaging conclusion.
- (xx) Members agreed that resolving the commercial implications remained key and understanding the degree of certainty around the potential income from 'Modernising Government' could pave the way to an agreement being reached. In purely commercial terms it was acknowledged that financially termination was hard to ignore although it failed to address the fundamental issue of POCL requiring a platform for automation.
- (xxi) Approved the Chairman's letter to Stephen Byers, which would emphasise that Option B as currently presented could not be supported.

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**DEPLOYMENT OF  
 EUROPEAN  
 PARCELS  
 STRATEGY  
 (POB(99)26)**

**PO99/47**

- (i) The Post Office's key competitors continued to seek new opportunities to develop internationally. The Dutch had acquired a French company "Jet Services" in December 1998 and could provide services across the mails, express and logistics markets. Deutsche Post had a presence across most of Western Europe and had recently acquired a Scandinavian company - Transoflex - for an estimated £350m. La Poste had done little internationally, although they had purchased a stake in DPD a German company The Post Office had previously considered but rejected. Through its link with General Parcel The Post Office now had solid coverage throughout Europe with 750 depots, 35,000 employees and a combined turnover of £3.5bn.
- (ii) The Post Office's key ambition was to obtain a controlling stake in General Parcel and had already taken steps towards this through the planned acquisition of depots in Austria. Additionally, during this first phase of development, further acquisitions and/or partnerships in the Netherlands, the Irish Republic and Sweden would be sought. These investments would be funded from the £75m agreed with Government for 1999-00 as part of the forthcoming White Paper.
- (iii) A further opportunity to acquire the French partner in General Parcel was also being explored. This, together with those ventures described above, would, if successful, enable a 60% share of General Parcel to be acquired.
- (iv) The second phase of development would focus on opportunities within the Spanish, Italian and Scandinavian markets which, if successful, would provide a 75% share of General Parcel at an estimated investment of just under £200m.  
  
noted further that
- (v) The completion statement for German Parcel would soon be available and would confirm that the acquisition had been on favourable terms. Volume was already above the 7% forecast, currently standing at 11%.
- (vi) The existing German management team had proved themselves competent and would be exposed to the Board at an appropriate time. The ability of the team in France was not as satisfactory and a shadow team was in place and would replace them in the near future.
- (vii) In operational terms the European road based operation

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was on a par with Deutsche Post and the Dutch. However, The Post Office was weak on logistics and air operations.

- (viii) In future it would be appropriate for investment cases under £10m which were uncontroversial and in line with strategy, to be devolved to the Investment Board for approval. On those occasions when the Board's authority was needed and a decision was required prior to a scheduled meeting, a short paper would be circulated for comment and consent.
- (ix) Authorised the Investment Board to make the final decision to authorise acquisitions in the Austrian, Dutch, Swedish and Irish markets and that in future, subject to the caveats in para (viii) above, cases under £10m would be devolved to the Investment Board.
- (x) Agreed that a full proposal to acquire the French partner in General Parcel would be brought to the Board (in correspondence, if necessary) if analysis of the proposal supported its progression.

**THE NATIONAL  
 LOTTERY PROJECT  
 (POB(99)27)**

**PO99/48**

- (i) Mike Kinski declared that through Stagecoach he had a working relationship with Richard Branson who had previously expressed an interest in operating the lottery licence.
- (ii) The Board had previously agreed the ongoing development of a National Lottery bid (PO98/130). Following further analysis the Board was now being asked to support The Post Office becoming a shareholder in Camelot, the current licence holder, and join the Camelot consortium bidding to win a second licence to run the lottery from October 2001. Financially the project had an NPV of £72m over the seven year period of the licence.
- (iii) The proposed strategy was considered financially risk free and it was widely accepted that having The Post office as part of any bid would enhance the chances of a consortiums' success.
- (iv) The proposal assumed that POCL would become a 20% shareholder in Camelot through a purchase of shares from Cadburys, De la Rue and Racal. Together with ICL, the shareholders would each hold a 20% stake. Negotiations currently indicated that an equity purchase price of £19.9m and a supply contract price improvement of £11m was a real possibility.
- (v) The only significant risk identified in joining Camelot was the negative publicity that had surrounded the lottery

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operator which could tarnish The Post Office's reputation. However, Camelot was sensitive to the media relations problems that had occurred during the early part of its operation and had taken steps to distance itself from these events.

- (vi) Competition issues were not regarded as a major issue.
- (vii) The Post Office had held discussions with Richard Branson who wanted to operate the lottery on a non-profit basis through his Branson foundation. Opportunities for The Post Office to make a profit under this proposal were negligible and therefore unattractive.
- (viii) The lottery licence would be awarded by five commissioners appointed by the Minister for Culture, Media and Sports. It was expected that they would seek to award the licence to the bid that would both increase the level of funds paid to good causes and be financially viable and sustainable over the licence period. Notwithstanding the public relations difficulties Camelot had experienced, it was widely accepted that the lottery was successful and granting the licence to an untried alternative bidder would be a considerable risk.

Noted further that

- (ix) Whilst the lottery provided low margin returns and in comparison to the European Strategy was not a top priority, it was strategically important to POCL whose core activities, such as bill payments were already under threat and the independent automated network of lottery terminals across the country provided a real opportunity for competitors to exploit.
- (x) A public relations strategy had been prepared.
- (xi) Funding of the equity purchase would not be required until 2000-01.
- (xii) Approved and Authorised the project team to:
  - negotiate and agree the Camelot contract within the financial parameters of the business case;
  - acquire an increased shareholding (up to 5% more) on similar terms if there is a reduction to four shareholders;
  - use a wholly owned subsidiary as a vehicle for the DTI consent, to hold Camelot equity and receive dividend payments.