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HM TREASURY CST → NO 10

GRO -> GRO

Page 2

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FAXED

to Jonathan
Powell with
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CONFIDENTIAL - COMMERCIAL

t.p.o.

GM / GN

PRIME MINISTER

BA/POCL

option C seems to leave option 2
considerable risk but the P.O. network
will shrink by next year I might
be a key objective. Is there any
"Option C" spec? **GRO**

The Fujitsu Board meet tomorrow morning to decide whether to continue with the Horizon project. The large affordability gap on the alternative option means that we were unable to provide the assurances which Fujitsu were hoping for by now. We have done and will continue to do everything we can, short of this, to keep Fujitsu in play. But we have also prepared a handling strategy in the event that Fujitsu walk away from the project.

Last night I met Alistair Darling, Stephen Byers and Charlie Falconer to discuss the way forward on the Horizon project.

Assessment of options

2. We agreed that option A (the Benefit Payments Card or BPC option) was unviable in view of ICL's failure to deliver and the breakdown in relations between the parties. Although option A currently looks like the cheapest option it is already three years delayed, and every six months additional delay adds a further £100 million to the costs. In addition, ICL appear increasingly disinclined to cooperate on option A.

3. We agreed that option B1 (the alternative option) has many attractions over



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Option A. However it looks currently unaffordable with a net present value (NPV) estimated at £870 million more than Option A which was the basis on which public expenditure provision was made for the project. Steve Byers reported on his discussions with the Post Office and with POCL about securing commitments to option B1 to make it affordable by narrowing the NPV gap. In short, thus far, the Post Office cannot give any financial commitment to bridge the £870 million NPV gap through the prospect of generating higher revenue or finding ways to reduce costs. However, Steve Byers believed that given a bit more time, it might be possible to persuade the Post Office to make some progress on this.

Discussions with ICL

4. In view of the undeliverability of option A and the fact that option B1, although attractive, remained unaffordable, but with the prospect that further work might bridge the funding gap, we decided that Steve Robson should speak to ICL today to communicate the following points:

- Ministers remained attracted to option B1 and the potential scope for modernising government, provided it could be made affordable;
- it was currently unaffordable;
- Ministers would therefore like to explore further in the first instance with the Post Office whether there were options that would bridge the affordability gap under option B1 by delivering additional revenues or reducing the costs. This process is likely to take 2-3 weeks.



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5. This was clearly much less than Fujitsu were hoping for ahead of the Board meeting tomorrow. ICL reacted calmly at the meeting with Steve. However, we subsequently received indications that this might not be sufficient to persuade ICL to recommend to Fujitsu that they continue the project.

6. In an effort to keep Fujitsu on board, Charlie and I therefore instructed Steve to have a further conversation with ICL, and to offer two further concessions:

- a cast iron guarantee that the Government would take a final decision before 12 May when ICL are legally required to file their accounts with Companies House;

- an offer to contribute towards ICL's ongoing costs of continuing the project pending a final decision by Ministers.

7. ICL indicated that they took this as a clear sign of goodwill from the Government, but emphasised that the final decision would be a matter for the Fujitsu Board at their meeting tomorrow morning (UK time). We should know their response soon after that.

8. We need to recognise that Fujitsu may decide these concessions are not enough. In the event that Fujitsu decide to terminate - an eventuality which we will do everything we reasonably can to prevent - the public sector parties would need to respond robustly, not least to protect their legal position. I attach draft lines to take, including a complete list of ICL/Fujitsu's failures to meet their contractual obligations on the Horizon project. All inquiries would be handled centrally by the Treasury press office.



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Implications of termination

9. How termination would affect ICL as a going concern is in many ways a matter for Fujitsu as the parent company. But informal soundings suggest that there is enough work from other contracts to avoid any job losses. ICL have other Government business, and are on course to sign a 10 year contract with Customs and Excise worth some £50 million a year around the end of May. Fujitsu/ICL will also no doubt look for some recompense from BA and POCL to set against the £300 million they have spent so far on the project. Legal advice suggests that ICL might reasonably expect to receive a payment of £150 million in the event of a negotiated settlement.

10. Over the last few months, officials have been giving careful thought to a fallback option (Option C) should the Horizon project fail. In that event, there would be a clear timetable for BA/DSS to move to an Automatic Credit Transfer (ACT) based method of paying benefits. The onus would be on POCL by then to have developed a commercial and IT strategy to allow a direct move to network banking, and to be in a position to offer benefit recipients the facility to withdraw cash from their bank accounts at post offices.

11. Our estimates suggest Option C (including the cost of equipping post offices with an alternative IT system) would have an NPV £270 million worse than the current baseline (option A) (assuming the move to ACT is completed in early 2004), but some £600 million better than B1 mainly accounted for by the additional banking costs under B1 and by the assumption that under C we would only need to pay ICL £150 million for the costs that they have spent so far.



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12. Over the CSR period both Option B1 and Option C might require total additional funding of £500 million compared with the current baseline (Option A), but we estimate there would be significant savings under Option C from 2002-03 onwards. And of course both B1 and C should make a positive contribution to moving forward our wider policy agenda.

Conclusion

13. Charlie, Stephen, Alistair and myself are all in agreement that this is the best way forward. We have done and will continue to do everything we can to try to keep Option B1, and therefore Fujitsu, in play. However, the affordability gap means that we are significantly short of what Fujitsu may have been expecting from us by now. I think it only fair to point out that even if Fujitsu decide tomorrow to maintain their involvement in discussions about Option B1, the outcome of Stephen Byers' further negotiations with POCL may still leave us with a very large affordability gap.

14. I am copying this minute to Alistair Darling (DSS), Stephen Byers (DTI), Charlie Falconer (Cabinet Office), and to Sir Richard Wilson and Geoff Mulgan (No. 10).

Yours sincerely

GRO

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GRO

ALAN MILBURN

*[approved by the Chief Secretary
and signed in his absence]*

22nd April 1999