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THE POST OFFICE

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URGENT - BY FAX & BY HAND

18 May 1999

The Rt Hon Stephen Byers MP
Secretary of State
Department Trade & Industry
1 Victoria Street
LONDON
SW1H 0ET

Dear Stephen,

Horizon

Since we last met, discussions have continued on Option B3 with your officials and the Treasury as you requested.

We have now reached a point where I think it is important that I restate The Post Office position on the various options available. First of all, we continue to believe that Option A is the right way forward, are still prepared to honour all current contracts, and believe that it is the only option that meets the Prime Minister's requirements as set out by Jeremy Heywood on 11 May 1999.

It is a matter of considerable regret to us that this option, we are told, is now off the table, as is Option B1, which is not seen by Ministers as value for money.

Our team has continued therefore to work on B3 against the background of the tests required by the Post Office Board and which I set out to you in my letter of 27 April 1999. For ease of reference they are appended at Annex A.

We still have not had from Government a precise definition of B3 as it affects The Post Office. However, our understanding is that under this option we would effectively be buying assets and an operating service from ICL under a schedule of fixed payments but without either the vital underpinning commitments associated with continued and automated benefit payments at post offices (at least, to anything like the levels of business and timescale under our existing agreements, or even Option A). Nor would the fundamental components for developing our new markets, for example, a card issued widely to many millions of our customers, be available.

We have now been asked to set out the terms under which B3 might become acceptable to us and in order to consider this, we have attempted to estimate the minimum income and cash funding profiles the Post Office would need from Government. These are shown at Annex B. In the light of them, we would therefore require the following:

- A guarantee that Government would provide this minimum income and cash funding additional to that envisaged under the proposed White Paper (without such a guarantee we would face serious balance sheet issues, including immediate liabilities to ICL that could exceed POCL's assets).

- An ACT timetable which would start in 2005.

- A firm commitment by Government to use the new B3 infrastructure extensively for existing and new services, including the possible use of a new smartcard for such services.

- Even if the 3 points above are met, there are a number of other significant issues outstanding which would require around 3 months work before any unconditional agreement could be signed with ICL.

Without these commitments, a large part of our core business, e.g. benefit payments, would be removed without the certainty of means to replace it with significant new business. In such circumstances it would be impossible for us to sustain the current nationwide network.

As a result, B3 does not appear to The Post Office to meet the tests I set out and thus provide an acceptable commercial case to which the Post Office Board could agree.

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Termination of the contracts and an honouring of commitments to automate post offices produce a similar set of direct and indirect consequences for The Post Office. Again we would need very significant funding similar to that described for B3, and the other financial and customer issues would also apply, together with payment for alternative automation of post offices. Compared to Option A, as matters stand, termination does not meet my commercial tests.

In addition as I said to you at our meeting on 6 May, we must also consider in the event of termination:

- impact of litigation including who holds the ring;
- communication;
- honouring both Government's and our commitment to automating the Counters network;
- the approach to be taken to sub-postmasters.

I hope this letter gives you a very clear statement of where The Post Office stands.

Yours sincerely,

GRO

DR NEVILLE BAIN

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Annex A

COMMERCIAL TESTS

1 Is the case a commercial one with fairly balanced risks? In other words one that gives a positive NPV at an appropriate discount rate.

2 Can the funds be generated in such a way that they do not prejudice other planned Post Office activities (which may have a much better return)?

3 What is the impact and timing of the costs on The Post Office and POCL Profit & Loss accounts? In particular the Board will need to consider if the proposal can be accommodated by Post Office Counters Ltd without technically bankrupting this business.

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Annex B

P&L AND FUNDING REQUIREMENTS

P&L:

POCL require the following additional income stream:

Year	99/00	00/01	01/02	02/03	03/04	04/05	05/06	06/07	07/08	08/09
£m	66	21	131	96	128	382	530	412	241	159

Cashflow:

Additional to the above (and excluding interest), POCL require the following funding from Government:

Year	99/00	00/01	01/02	02/03	03/04	04/05	05/06	06/07	07/08	08/09
£m	101	244								

The repayment profile of such funding (net of interest) will be as follows:

Year	99/00	00/01	01/02	02/03	03/04	04/05	05/06	06/07	07/08	08/09
£m			61	62	65	66	56	20		

These numbers are at outturn prices and are indicative only, and will need to be revised in the light of final agreements. They reflect the terms of the "counter offer" being put by HMT to ICL on the evening of 17 May 1999.