

**RESTRICTED - POLICY AND COMMERCIAL**

To:

**SECRETARY OF STATE** ) separate  
**MR MCCARTNEY** ) copies

From:

**DAVID SIBBICK**

Director Posts

BPR **GRO**

**GRO**

14 December 1998

c Mr Scholar  
c Mr Macdonald  
Mr Baker CGBPS  
Mr Macintyre CII  
Mr Fraser IBB  
Mr Wheeler IMT  
Mr Sklaroff COM  
Mrs Britton PORT  
Mr Osborne Legal C  
Mr Hosker FRM  
Dr Hopkins CII  
Mr Whitehead CGBPS  
Ms Anderson CGBPS  
Mr Corry SpAdv  
Mr Wegg Prosser SpAdv

**BA/POCL COUNTERS AUTOMATION PROJECT: HORIZON**

**Issue**

1.1 You are to meet with your colleagues this afternoon (14 December) to decide the future of the Horizon project. What should your line be?

1.2 The Secretary of State for Social Security has written to colleagues making clear his view that ICL have again failed to offer a satisfactory commercial basis for taking the project forward, and that Horizon should now be terminated. Should you respond?

**Recommendation**

2.1 Although ICL's latest offer does not go as far as the public sector side demanded, the company have now moved substantively and decisively in a number of key areas. The Post Office now believe that the project makes commercial sense for them, and want Ministers to agree that it can go ahead. There are wider DTI/Government reasons for wanting to avoid cancellation. **You should strongly support.**

2.2 The letter from Alistair Darling dated 11 December seeks to comprehensively rubbish the latest ICL proposals. It is (polite form) disingenuous in a number of key respects, and if accepted at face value by your colleagues would rightly be regarded as fully justifying a decision to terminate the project forthwith. **It is therefore very important that you should write at once to your colleagues setting the record straight. It will be helpful to your cause if as many of them as possible have an opportunity to read your response before this afternoon's meeting.** A suggested draft, together with a copy of Alistair Darling's

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letter, is at Annex A. The arguments deployed in the draft letter are essentially those you will need for this afternoon's meeting, though we have also provided separate briefing in the conventional format (Annex F).

**Background**

3. The negotiations between BA/POCL and ICL under the independent chairmanship of Graham Corbett failed to achieve a commercial agreement between the contracting parties. Ministers decided to allow a further two weeks for bilateral discussions between ICL and POCL. At the end of that period ICL tabled a further proposal on 9 November which was unacceptable in many respects to the public sector, and effectively widened the gap between the two sides. One positive outcome however was the signing of draft Heads of Agreements between POCL and ICL on a partnership arrangement which added value to the contract for ICL. Ministers decided to allow a further two weeks - to 9 December - to give a final opportunity for ICL to come forward with an acceptable offer. Adrian Montague was appointed as the facilitator for this process. The Chief Secretary's letter of 20 November (Annex B) to Keith Todd, the Managing Director of ICL set out the background. These further discussions resulted in a substantially revised package from ICL, described in broad terms in Keith Todd's letter of 9 December (Annex C). A letter from the Post Office Chairman arguing that the ICL offer at last provided a commercial basis for taking forward the project, and urging Ministers to adopt that course, is at Annex D.

**Argument**

4. The main elements of the ICL proposal are:

- Fujitsu will stand fully behind the project and provide a legally enforceable guarantee for its funding and performance - this removes a critical risk (of £several hundred million) to the public sector;
- ICL have confirmed that they will retain all the fraud liabilities as per their existing contracts;
- ICL have agreed that the system must be seen to work in live operation before POCL and BA accept it;
- ICL have moved £80-100m towards the public sector in their commercial proposals, and have accepted additional volume risk.

5. This Department has consistently maintained the position that provided an acceptable commercial basis could be established for continuing with the project, we support continuation - on the grounds that it is in the best interests of the post office network and

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avoids the wider negative repercussions for Government that termination would entail. These would include:

- damage to subpostmaster confidence resulting from an announcement of termination and reduction in their income as DSS inevitably seek to quickly switch benefit claimants to ACT - resulting in network instability and post office closures (payment of benefit payment floor will not compensate for lost footfall);
- delay to post office automation resulting in potential loss of PO clients;
- damage to ICL - on a least bad scenario this might involve damage to their reputation and on a worst case might destroy their chances of flotation and Fujitsu might decide to divest themselves of the company;
- damage to relations with Fujitsu - as evidenced by recent exchanges between Fujitsu and Sir David Wright, our Ambassador in Japan;
- potential damage to credibility of PFI, especially for this type of project; and
- the financial risks associated with litigation which might be in the range of £100- 200m

6. Continuation in our view offers POCL the best prospect of maintaining a stable network and managing a transition to ACT - which we accept represents the most cost effective means of paying benefits in the long term, and for which the rate of uptake is increasing in any case.


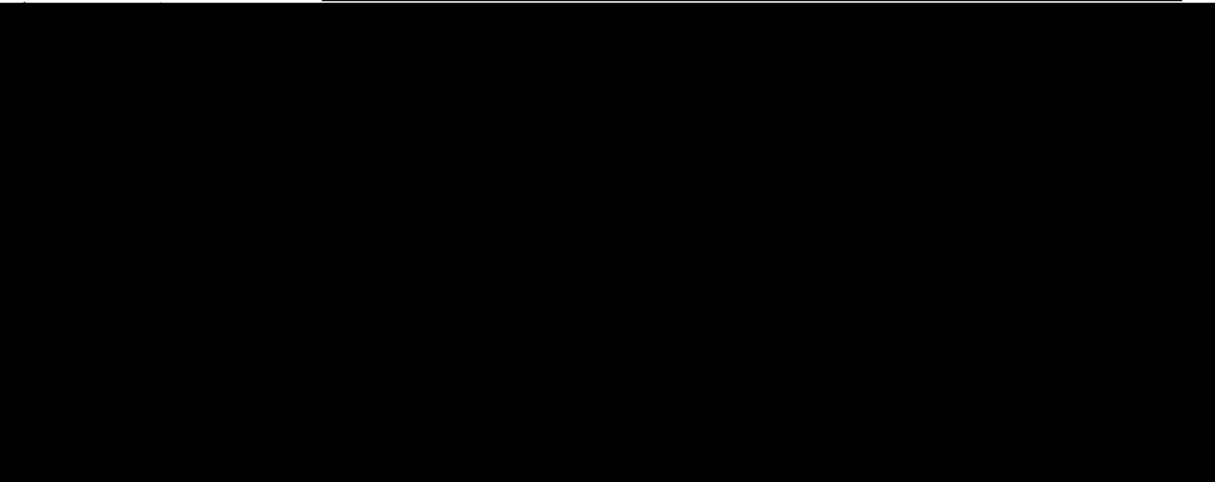
7. It buys POCL a slightly longer time period in which to establish a full automated banking facility on which it can offer front-end banking facilities and to manage the transition to ACT.

8. The Value for Money analyses undertaken by the working group and KPMG suggest that savings from a switch to ACT may well be offset by POCL losses. However, these analyses need to be treated with caution given the uncertainties surrounding them. The latest analysis suggests that cancellation (without the benefit payment floor) may on a narrow definition offer marginally better value for money than continuation.

9. This afternoon's meeting can be expected to address the following questions:

1. Is the revised ICL offer acceptable?
2. How does it compare with the fall-back options
3. Should the Government continue with the project or terminate?

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4. Next steps
5. If the Government terminates the project, what legal notice should they serve on ICL?
6. What would the Government say publicly?
10. An agenda suggesting the issues for discussion prepared by HM Treasury is attached at Annex E.
11. If the decision is to terminate, a secondary decision will be needed on the legal route to achieve termination.   

12. A draft report by officials setting out this issue more fully, together with a preliminary analysis of the ICL offer, the background and the main arguments for and against termination is attached for reference at Annex G. It does NOT seek to make recommendations.
13. Key points and supplementary lines to take for your meeting are attached at Annex F.

DAVID SIBBICK