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BA/POCL file<sup>266</sup>

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From: Andrew Stott BA/POCL  
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cc: (minute only)  
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Mr Riggs BA  
Mr Stewart BA  
Mr Wylie SSA  
me

#### MEMORANDUM OF UNDERSTANDING BETWEEN BA AND POCL

I attach a copy of the final text of the Memorandum of Understanding between BA and POCL which underpins our programme and which has allowed the issue of the SSR.

2. The high-level joint objectives of the Programme are set out in paragraph 4 (a re-statement of those approved by the first meeting of the Steering Committee) and specific objectives for BA and POCL, which the other party recognises and supports, are in Annexes 1 and 2. All these objectives are, of course, already reflected in the SSR.

3. Likely lead contractual responsibilities for the services provided by the PFI supplier are in Annex 3, although this depends to some extent on the suppliers' proposals and it remains the Programme's responsibility to conduct the combined procurement for all these contracts.

4. Other features of the agreement include a commitment to ensuring that the services are provided at lowest value-for-money cost to meet the business case and the programme objectives of each; a definition of the ownership of the benefit payment card and of the guidelines for its use; a common aim of continually reducing the end-to-end cost of benefit payment through post offices; an agreement that the service contracts should have sufficient flexibility to allow for the migration of existing POCL services and the addition of other non-BA products in the future; a commitment to automate all post offices to some degree; and an agreement to co-operate to rollout the POCL automation and fully implement the card system of benefit payment at the earliest possible date.

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5. This MOU and the SSR constitute the Programme's baseline for our customers' requirements. Now we have to deliver to it.

**GRO**

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**"BRINGING TECHNOLOGY TO POST OFFICES AND BENEFIT  
PAYMENTS"**

**MEMORANDUM OF UNDERSTANDING BETWEEN BA AND POCL**

**Purpose**

1. This document summarises the business and commercial understanding so far reached between the parties at paragraph 3 around the programme known as "Bringing Technology to Post Offices and Benefits Payments" and so concerns the procurement of "BA/POCL Automation" and associated issues.
2. As such, it underpins, and is consistent with, the Statement of Service Requirement (SSR) and it is so dated in parallel with the SSR's issue of April 1995 to the prospective suppliers collectively known in this document as CONSCO.

**Parties**

3. It has been reached following discussion between the following parties: the Benefits Agency (BA); the Social Security Agency for Northern Ireland (SSA); and Post Office Counters Ltd (POCL). For the purpose of this document BA is used as the abbreviation to represent both BA and SSA (and other parts of the DSS and DHSS (NI) respectively) unless otherwise stated.

**Objectives**

4. All parties recognise and commit to the programme's overall service objectives which can be expressed as:



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- a fraud-free method of paying benefits at post offices that is automated, has lower end-to-end costs than the current paper-based process, with continuously reducing overall administration costs year on year;
  - extending automation to POCL's other client transactions, its products and its support processes to improve competitiveness, increase efficiency, and to enable greater commercial opportunities for POCL;
  - full and speedy reconciliation of benefits payments, with accounting arrangements consistent with recognised accountancy practices;
  - an improved overall service to the parties' customers.
5. In addition, there are detailed sets of objectives for BA and for POCL. These have been issued with the SSR, and are at Annex 1 for BA, and Annex 2 for POCL.

**Status**

6. This "Memorandum of Understanding" is not legally binding, but reflects the clear intention of the parties at this stage of the project. It is intended to represent clearly a summary of commercial principles reached to date so that the various commercial arrangements between BA, POCL and CONSCO, and BA/POCL and CONSCO and between BA and POCL can be organised around

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these principles once the reactions to the SSR are known from suppliers (including their commercial proposals) and once full negotiation with any chosen supplier then commences. Full commercial negotiations will also then begin between the parties at 3 above. As such, this document should help to avoid confusion as the programme develops, and also aid the supplier evaluation process. It gives a clear statement of commercial intent by BA and by POCL, without eliminating the necessary commercial flexibility that must, at this stage, be inherent in the programme.

7. Having considered the programme objectives and the likely financial consequences, the parties believe that, subject to appropriate commercial responses, the project has every prospect of progressing. This belief is founded on:
  - a. an expectation that, consistent with the service requirement, tenderers will do all in their power to minimise equipping, maintenance and services costs and hence prices;
  - b. an expectation that all parties will co-operate to achieve the full benefit of the programme of work as rapidly as possible.
  - c. agreement that BA and POCL will eliminate unnecessary features of service requirements, invite suppliers to put forward suggestions for further tightening and economy, and consider these suggestions on their value for money merit.



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- d. that the parties will co-operate to deliver the service components as economically as possible.
- e. an understanding that the overall business case for automating benefit payments at post offices has a positive return to the public sector.

**Commercial Roles and Responsibilities between BA/POCL and CONSCO**

- 8. BA and POCL recognise that the costs to CONSCO and to one another are significant, and commit to ensuring that the costs of the specification, design and operation of the new services are provided at lowest value-for-money cost to meet each others' respective business cases and the programme objectives and that opportunities to use and exploit further the services required for the this procurement are encouraged and incentivised.
- 9. POCL and BA have an expectation that no fraud risk will arise from CONSCO, commensurate with a value-for-money approach to risk elimination, from the new automated benefits payment process. POCL and BA will need to be satisfied that any residual liabilities are controlled and that practical liability for fraudulent losses should rest with the service supplier, who would usually be CONSCO, except where BA or POCL had failed to provide a service on which CONSCO had expressly depended. Evaluation of proposals from CONSCO will take this into account.



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10. Contracts between BA or POCL and CONSCO may be under an "umbrella contract" between BA, POCL and CONSCO. This may cover issues such as equality of treatment, information provided, programme implementation dates, warranty and liability rules.
11. BA and POCL will each take the lead contracting role with CONSCO for various components of service to be provided under the procurement process. However, it is also agreed that for certain services, whereas one party will take the lead role, the other party will have certain necessary rights to specify security and service standards or requirements because of the interdependency of the service components.
12. Agreement has been reached on the lead contractor by service components. This is set out at Annex 3. It is recognised that this may need review and change in the light of suppliers' proposals.
13. In addition to those components under the procurement process, there are some major projects which will interface with the programme procurement, but which will themselves be probably supplied separately (eg CAPs by BA, and possibly TIP by POCL). These will need to be managed successfully and mutual assurances to BA, POCL and CONSCO (to be defined precisely later) will need to be given.



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14. The Benefit Payment Card will be the property of and remain within the control of the Secretary of State for Social Security. Consequently, BA will lead on card management services in respect of the benefit payment card. The branding in terms of text on and design of the card will be the subject of discussion between BA and POCL, to take account of customer acceptability and to make it clear, in normal circumstances, the card is to be used to cash social security payments at post offices. CONSCO will not be permitted to seek and arrange for the card to be accepted in retail outlets other than post offices or BA offices in normal circumstances. If other outlets are required, typically in emergency/force majeure circumstances BA will use their best endeavours to agree such arrangements with POCL in advance of any notification being given to CONSCO.
15. The contracts for the management and control of the use of the card will be in line with Government policy on both maintaining a nationwide network of post offices and in providing customer choice in the method by which they can receive benefit payments and will not constrain the development of any changes in that policy.
16. The card is intended for use as a benefit payment card and other related benefit and social security purposes only. Where relevant and appropriate, POCL will be given the opportunity to propose how its service could be used for these other purposes. It is accepted that, in certain circumstances, eg migration to a Government multi-purpose smartcard, there could be a need for





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revised contracts between BA and CONSCO and BA and POCL. Under such circumstances, the commercial principles between BA and POCL, and BA/POCL and CONSCO, as described in this memorandum, will need to be carried forward into new contracts, unless otherwise agreed by the parties.

17. The Secretary of State for Social Security owns all customer data relating to benefit payment, including the NI number. CONSCO will have no right of ownership or use of customer data by means of the service it supplies without the express consent of BA and/or POCL as appropriate. However, BA will welcome applications from POCL for use of non-sensitive information contained on POCL infrastructure systems for use in POCL business, on terms to be agreed. It is recognised that BA will be constrained by the requirements of the Data Protection Act and by the overriding requirement to preserve confidentiality of BA customers' personal social security data. Data will also be required for financial settlement and reconciliation and the precise requirements will be agreed between BA and POCL.

**Commercial Principles between BA/POCL and CONSCO**

18. Without prejudice to BA's right to market the system for payment of benefits at post offices, POCL will control the rights for using and marketing the services provided by the service provider in its post offices and must be free to use these to transact business for any of its clients subject to implementing the agreed security and service delivery safeguards for those clients (including BA).



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19. BA/POCL contracts with CONSCO should match the contract lengths of any contracts between BA and POCL, except in the case of BA's card management service contract with CONSCO which may be for a different period. If the card management contract were to be recompeted, POCL would be involved in the specification of any product changes and impact on the main contract would be taken into account.
20. BA and POCL will consider opportunities, where efficient so to do, to multi-source appropriate aspects of the systems during the procurement process, and during and at the end of the contract.
21. Real competition for the future at the point of retendering supply will be written into contracts with CONSCO, including arrangements to ensure smooth transition in the event of a new supplier.
22. BA/POCL agreement on Intellectual Property Rights is carefully, and more fully, described in the SSR (Chapter 8.4). In summary, rights are recognised in certain defined areas (for example, outside the UK for CONSCO) and are subject to relevant security, operational and commercial needs of BA and POCL, and to ensure continuity of service in any extraordinary operational circumstances or at the time of retendering supply.



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**RESTRICTED - COMMERCIAL****Contract Structures between BA and POCL**

23. The following contract structure between BA and POCL is likely to apply, subject to proposals awaited from CONSCO.
24. There will be a new "transaction contract" (Contract "A") to cover that part of the service POCL supplies to BA for which there are not POCL/CONSCO supply contracts in place. In many respects, Contract A's pricing will cover many of the costs associated with the previous and current "main" POCL/BA contract. Pricing for this contract will reflect the factors in paragraph 36 below.
25. There will be a new "transmission contract" (Contract "B") for services POCL supply to BA for which there will be an associated POCL/ CONSCO contract(s). Pricing for this contract will reflect the factors in the paragraph 37 below.
26. Contracts "A" and "B" will run in parallel, be of matching lengths between each other, and match the length of any joint BA/POCL "umbrella contract" with CONSCO to cover issues that are the same to both contracts (see paragraph 10).
27. It is possible that there will be separate contracts between POCL and SSA as well as between POCL and BA, but it is intended to carry over all the commercial principles and structures into both sets of contracts as far as possible.



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**RESTRICTED - COMMERCIAL****Commercial principles between BA and POCL**

28. Contract "A" will be on a "closed book" basis; Contract "B" will require sharing of volume and financial data relating to the benefit payment product and totals, but not including specific data about other individual clients. It may involve certification by POCL and/or by independent third parties, as agreed between all parties. This is to ensure adherence to commercial principles or formulae agreed between BA/POCL and to the basis of how prices have been, and are to be, struck with CONSCO.
29. It is agreed that BA and POCL are stakeholders in the overall process for benefit payment through post offices, with the common aim of continually reducing its end-to-end cost. It is also agreed that BA and POCL have their own other objectives, many of which are complementary, and all of which are acknowledged as important by the other. These will be pursued in a spirit of partnership but with respect to the legitimate aims of the two distinct businesses.
30. Any commercial formulae and structures should aim to create incentives for all parties (including CONSCO) to co-operate fully to fulfil the overall objectives and to yield continuous financial advantage (year-on-year) both to BA and to POCL.





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31. It is agreed that BA's overriding interest is in the control, and cost reduction of, a fraud-free benefits payment system. It is acknowledged that changes to the specification of this process are primarily driven by BA's needs (agreed by POCL as appropriate) and so the costs and rewards of those changes primarily fall to BA. POCL agrees to use its best endeavours to facilitate this within the constraints of POCL's other commercial obligations.

32. At the same time, POCL has a complementary aim of automating, where appropriate, its other client transactions, products and support processes and the costs and rewards of these initiatives (some of which are not yet fully defined or agreed by its other clients) will fall primarily to POCL and/or its other clients. It is agreed that the service contracts should have sufficient flexibility to allow for the migration of existing services and the addition of other non-BA products at appropriate points in the future. While the BA will aim to co-operate fully with this, it expects this to be at no cost or benefit to itself. If a BA contribution to these costs is not avoided, BA will expect an appropriate share in subsequent rewards.

33. It is agreed that it is not within BA's remit to become directly involved in the running of POCL's activities or services. Specifically, and taking account of agreed client requirements, POCL will retain control itself of its critical business processes and relationships, such as:



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- quality of service (queueing time and other customer charter measures) to its customers
- contractual relationships with its agents (ie subpostmasters and franchisees)
- contractual relationships with its clients
- policy control of its network
- its reconciliation, settlement, and key infrastructure support, processes.

34. Inter alia, this implies that POCL will continue to price for its services across all its clients, and retain commercial confidentiality in so doing, but within a pricing policy agreed with government to ensure no unfair cross-subsidy, and within contractual frameworks that are equitable and which recognise the relative importance of volumes, value and investments by different clients to and across those parts of POCL's costs structure that are relevant to them (including an element of fixed costs which are common to all).

35. Exact pricing formulae cannot be agreed until proposals from CONSCO are received, and after detailed negotiation between BA and POCL then takes place.

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36. However, the basis for the pricing of Contract "A" will include recognition of the following factors and cost elements:

- a. A baseline equal to the overall price of the contract for 1995/96, excluding ESNS. The total sum payable for 1995/96 has been agreed at £358m including POPOS, compensation for errors and audit certificates as provided for in (g) below.

The baseline will therefore consist of the following key elements:

- (i) A fixed fee of £129.99m adjusted for efficiency discount (-2%), RPI (3.4%) and the operational discount (£6.7m).
- (ii) A variable fee of £144.41m based on an agreed and contractual traffic assumption of 850.8m transactions at a rate of 16.75p per transaction, adjusted for the efficiency discount (-2%) and RPI (3.4%).
- (iii) A financial charge of £81.83m on an agreed and contractual turnover assumption of £49.85bn at a rate of 16.75p per £100, adjusted for the efficiency discount (-2%).
- (iv) A reduction of £0.23m in lieu of compensation and liability claims (see c (xii)).



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- (v) A fee of £2m, including VAT, for POPOS assuming a network of 14,461 offices.

The terms and conditions will be part of a formal contract agreement between the parties, and there will be a formal exchange of letters in respect of the 1995/96 price. In the event that RPI, outturn traffic or cashflow for the year differ from the estimates used there will be no adjustment to the net fees.

Payment of the fee will be made by the mid point of each quarter, ie the nearest banking days on or prior to 15 May, 15 August, 15 November and 15 February.

- b. A revised forecast of the traffic and turnover for 1995/96 will be agreed between the parties by end February 1996 and used as the basis of estimates for 1996/97 in the following way. The 1995/96 revised estimate of volumes of paper based and electronic traffic and turnover will be updated to take account of latest trends and the parties will agree estimates for these three variables before the end of February 1996 for 1996/97.
- c. The contract structure for 1996/97 until and including the last year of POCL's contract with CONSCO will be on the same basis as that for 1995/96 but will also take account of the following elements which are also reflected in Annex 4.





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(i) The electronic volume related fee per payment transaction for 1996/97 will be at a price higher or lower than the fee computed as in a(ii) above to reflect an assessment to be negotiated before 1996/97 in the light of CONSCO's proposals of the impact of the electronic service on POCL's costs.

(ii) In particular it is envisaged that the electronic service may involve additional counter service time and there may be more enquiries. The parties agree that they intend that the adjustment to the unit price per transaction should be agreed before implementation of the new contract with CONSCO and reflect the estimated net cost of the differential impact of the electronic system of payment compared with the manual system of payment. They further agree that this initial assessment should be based on synthetic simulation where possible and be jointly agreed but subject to review with live timings when available from the demonstrator and pilot phases. The variable charge for electronic transactions will take account of any transaction or service impact arising from Contract B. The actual level of impact will be reviewed during the demonstrator and pilot phases and will need to be agreed by both parties. BA and POCL will also establish a baseline for other front office activity eg enquiries, aborted transactions, against which any impact can be assessed. Changes in back office activity resulting from the revised BA product specification and changes which are a

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direct result of automation (such as receiving, stamping, storing and distributing order books, preparing and checking stop lists) will be taken into account in assessing overall impact.

(iii) The turnover fee for 1996/97 onwards will be computed by applying the estimated turnover for 1996/97 to the unit rate of £0.1675 per £100, less the appropriate efficiency discount (c vi)).

For the avoidance of doubt, it is understood that the turnover estimate will be agreed between BA and POCL based on the estimated actual cash passing through post offices, taking account of benefit uprating, changes to benefits and switches to/from other methods of payment on a best estimate basis. Accordingly, no further adjustment for RPI is envisaged.

(iv) An adjustment will be made to the fixed fee in proportion to the number of post offices automated and will be based on payment of a £3m fee for full roll-out, as agreed between POCL, CONSCO and BA. The adjustment will be subject to uprating for RPI and to efficiency discount from the year in which it is payable, and will be paid in the year following roll-out ie if 33% of post offices were automated in 1996/97 then £1m would be paid as part of the quarterly payments in 1997/98. The £3m adjustment will be an ongoing annual addition to the fixed fee following completion of roll-out to post offices.



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(v) The fixed charges will be adjusted to reflect the transition of Girocheques to a card based product, so that a total of £14.74m at 1994/95 prices and subject to adjustment for efficiency and RPI is added to the fixed costs in proportion to the stages in the transition, with the total addition made when the final Girocheques are transferred to the new system. The intention is to match in timing as far as possible the additional costs to BA of the increment in fixed charges with reductions in fixed charge from POCL to Girobank and then reflected to BA.

(vi) Efficiency discounts will apply to the total fee less POPOS and liability as follows:

|         | %  |       |    |
|---------|----|-------|----|
| 1996/97 | 1% | 00/01 | 1% |
| 1997/98 | 1% | 01/02 | 1% |
| 1998/99 | 1% | 02/03 | 1% |
| 1999/00 | 1% | 03/04 | 1% |

The end date will align with the CONSCO contract which is not expected to run beyond 03/04.

(vii) The efficiency discounts in the years following completion of the roll-out of automation of post offices may be increased, with a ceiling of 3%, depending on the growth of POCL business income. This will be determined by reference to the



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increase in POCL income when compared with the business income of POCL in 1995/96 (the base year) increased by the RPI factors used for fee calculations. In making this comparison, income in each year will be reduced by an amount equal to POCL's payments to CONSCO for counter infrastructure and transaction management services in that year.

POCL will provide BA with provisional estimates of income and the deductible payments to CONSCO within 2 months of the end of each POCL financial year. Where these show that the thresholds for triggering efficiency discounts have been exceeded, this will be reflected back into the fees for the most co-terminus year of Contract "A" fee to be made by BA to POCL. Final adjustments will be made following publication of audited accounts, again by adjusting the next appropriate BA fee payment.

The efficiency percentages to be applied are as follows:

|                             |       |
|-----------------------------|-------|
| Less than 125% of base year | 1%    |
| 125%-130%                   | 1.25% |
| 130%-135%                   | 1.50% |
| 135%-140%                   | 1.75% |
| 140%-145%                   | 2.00% |
| 145%-150%                   | 2.50% |
| above 150%                  | 3.0%  |





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(viii) The RPI forecast for quarterly payment purposes after 1995/96 will be the outturn RPI figure for the last available quarter. For settlement purposes a quarterly average RPI figure will be used based on the actual monthly RPI as published in the monthly digest of statistics (currently table 18.1) a publication of the government statistical service. The series to be used is the Retail Price Index all items. It shall be open to the parties jointly to agree a different methodology to carry into effect an agreed intention to reflect actual experience of prices as measured by RPI - all items on a quarterly basis for fees due for that quarter.

(ix) Where the relevant RPI rises above 8% per annum then the % uplift will be reviewed taking account of the movement of POCL's main cost drivers and any anti-inflation policy of the government over the period and any planned action will be agreed in advance of the financial year in question.

(x) A charge of £2m for POPOS has been agreed for 1995/96 and this will be uprated by RPI in subsequent years so long as BA requires the service. Any additions to BA's requirements for media services over and above this baseline will be negotiated separately. It is currently envisaged that BA will continue to use media services provided by POCL throughout the contract period. We will use our best endeavours to define this before the BA/POCL contract is finalised.



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(xi) Advance funding arrangements will be as per those set out in the 1994/95 agreement between BA and POCL, but will be reviewed between the parties by March 1997 and then again by March 1999 and March 2002. The aim will be to assess advance funding needs as accurately as possible and keep the period of advance funding to the level necessary to ensure cash is available in post offices for payment of benefit.

(xii) The fee for 1995/96 allows for a payment of £0.23m from POCL to BA as full and final settlement of claims for compensation and liability for errors in respect of the paper based payment system. A separate agreement applies in the event of claims in respect of the ESNS service.

It is currently envisaged that BA, CONSCO and POCL will each bear responsibility for fraud losses, errors or negligence directly arising from services within the respective parties remit or control. The actual allocation of risk and its funding will need to be agreed between the parties as part of a risk analysis which will form part of the evaluation of CONSCO's proposals.

The evaluation will have regard to the following principles:



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(c) BA, POCL and CONSCO will co-operate to minimise fraud and all parties are expected to provide for ongoing monitoring of fraud levels. If fraud in any one month exceeds £100k then all parties will be expected to agree and implement appropriate remedial measures and cost sharing.

(d) Liability for the paper based system from 1996/97 onwards will not exceed £0.23m + RPI in any one year, and will be reduced in accordance with the roll-out of the automated system.

(e) Any claims for compensation/losses which are not automatically verified or identified by the system will need to be supported by timely proof/evidence and such claims will exclude payments deemed to have been made under duress which are linked to attempted or actual theft.

(xiii) In a situation of declining volumes of benefit transactions any change on the overall charge will be capped at a maximum reduction of 3% on the previous years price (excluding RPI on the latest years fee). The base year will be 1995/96 but this will be adjusted to allow for the increased income/volume arising from the transition of girocheques.





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Each year, starting in 1996/97, a guaranteed "floor" charge will be calculated which will be payable regardless of the actual volumes and values of benefit transactions.

In general, the floor will be equal the previous year's price less 3% then uprated in line with the year-on-year changes in the RPI.

In years where there is migration of Girocheque transactions, the floor will be increased by the following:

- (a) A percentage of £14.74m equal to the percentage of Girocheques to be transferred, reduced by cumulative efficiency discounts from the year of migration and increased by the change in RPI from 1994/95.
- (b) 16.75p per girocheque transaction to be transferred, reduced by cumulative efficiency discounts from 1995/96 and increased by the change in RPI from 1994/95.
- (c) 16.75p per £100 value of girocheque payments to be transferred, reduced by cumulative efficiency discounts from 1995/96.



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Annex 4 shows an example of how such a floor might apply.

Once the floor level has been calculated RPI will be added back calculated as in paragraph c (viii) above.

(xiv) Invoicing of the fees will be such as to enable BA to settle invoices by the middle of each quarter. During roll-out it is assumed that the level of the fee will be as agreed at the start of the financial year using annual volume and value forecasts. With roll-out of automated systems and as improved financial information becomes available, BA and POCL will move to the use of quarterly estimates of fees based on actual volumes/value and RPI and with final revisions based on year end outturn subject to the mechanism set out at paragraph (x) above.

(xv) The pricing mechanism set out at paragraph (c (ii)) for the flowthrough of any additional service time from Contract "B" is not intended to be applied to any new transactions or services requested by BA over and above those provided within the baseline agreement.

(xvi) The charges do not include provision for the storage/issue of cards to customers which will be priced separately following agreement between BA, CONSCO, and POCL if appropriate.



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- (d) The financial model at Annex 4 reflects the factors, principles and metrics described in the preceding paragraph. The figures are illustrative in that the volume and value assumptions may vary. In summary if the assumptions are correct then the total payments due (excluding incentives) at constant 1994/95 prices would be as follows:

| £m    |       |       |       |
|-------|-------|-------|-------|
| 96/97 | 343.3 | 00/01 | 377.3 |
| 97/98 | 367.2 | 01/02 | 372.4 |
| 98/99 | 385.2 | 02/03 | 367.5 |
| 99/00 | 382.2 | 03/04 | 364.4 |

- (e) Currently, the BA and SSA have separate contracts with POCL. Unlike that for BA, the existing SSA contract runs to 31 March 1996 and is on an overall price basis rather than constructed around a fixed charge and variable charges related to volume and value of transactions. It will be necessary, therefore, for SSA to have a separate Contract "A" with POCL which will start one year after but terminate concurrently with BA's contract "A" and which will start from the baseline already agreed for 1995/96 between SSA and POCL. The SSA will provide similar forecasts in respect of payments at Northern Ireland post offices. The construction of the overall charge will be for negotiation between SSA and POCL, but it will apply as many of the principles from this paragraph as is deemed practicable.



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(f) BA is intending to offer money incentives to POCL to encourage the quick and efficient implementation of the new method of payment. In particular, incentives may be offered for any or all of the following:

- completion of roll-out of the infrastructure and electronic equipment in all post offices by a given time;
- the cessation of the need to use any Girocheques for benefit payment;
- the complete cessation of all paper based methods of payment in post offices;
- satisfactory operation of the new method of payment in individual post offices.

It is intended that the maximum achievable value of these incentives will be £10m in total and the conditions for payment will be determined once CONSCO's proposals are accepted. They will be paid as additions to the annual fee, will be demanding but achievable, will be designed to relate only to circumstances in which POCL, its agents, contractors and suppliers can take responsibility for achieving a defined result and will only be paid where both parties agree the parameters for performance.





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- (g) Audit reports and certificates will continue to be provided as detailed in the 1994/95 contract and the 1994/95 value of £113k is deemed to be included within the contract price. Additional and/or changed requirements will be priced accordingly.

37. The formula for the pricing of contract "B" will take account of the following factors and cost elements:

- a. Contract "B" between BA and POCL will be aligned with the contract between POCL and CONSCO in terms of period and pricing structure. Both BA and POCL expect the CONSCO pricing structure to be based on the usage and intensity of usage by service element. However the pricing structure may need to be changed in the light of contract negotiations with CONSCO.
- b. While the contract for counter infrastructure and TMS will be between CONSCO and POCL it will take account of the views of BA and adhere to the principles in this MOU. They will seek to include reduced prices year on year to reflect both increased efficiency and the increasing volumes as the automation project rolls out. Both the POCL and BA commercial teams will have access to relevant specifications, proposed costs and price mechanisms during CONSCO negotiations and selection of the final supplier, subject to commercial confidentiality.



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- c. BA and POCL will co-operate in dealing with CONSCO to ensure that both parties can satisfy themselves that CONSCO's costs are apportioned fairly between CMS, PAS, TMS and counter infrastructure, and within TMS and counter infrastructure between service elements. CONSCO, through the terms of their responses to the SSR and final bids, will be encouraged to base their charges on a unit transaction per service element basis taking account of the various items of equipment, software and transmission costs needed to support each service element.
- d. It is expected that charges will be calculated as the sum of BA's usage of each of the service elements used for benefit payment related services. POCL will pass on to BA, without mark-up but with respect to the management and audit fees described in (e) below, its share of the charge as calculated by CONSCO based on usage and intensity, such share to be monitored annually. Timing of payments will take account of terms under Contract "A" and those between POCL and CONSCO.
- e. BA will agree with POCL a management and audit fee in respect of POCL's contract with CONSCO. BA will not pay for service elements which are not used for benefit payments eg Postshops. BA and POCL will meet the costs of any higher specification required by themselves only. BA will also meet the net costs or receive the



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net benefits of any impact on Contract "A", eg transaction time and reduced reconciliation activity.

- f. POCL is committed to incorporating transaction services for other clients via the CONSCO network, as soon as it can agree a programme with its existing clients and develop new products and services. In particular POCL is committed to using the EPOS element of the service for all sales wherever practicable.
- g. The unit costs for any POCL client (including BA) will reflect any additional costs caused by specific client needs. Where additional costs in excess of £100K are created as a result of one client's needs impacting on other client's business (eg on its security), then the additional costs will be borne by the client whose needs have caused the impact. This will be achieved by modification to the relevant client's pricing mechanism. Where such costs are incurred outside the scope of POCL's contract with CONSCO or of Contract "B" activity, POCL will have the right to receive an independent assessment of the costs claimed by the affected client.
- h. BA and POCL will provide forecast volumes of transactions through the services provided by CONSCO. If the contract with CONSCO provides for volume discounts, for either overall usage or specifically for BA usage, then such savings, when they apply, will be reflected in the fees outlined above.



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- i. BA and POCL will co-operate to ensure forecasts to CONSCO are realistically based, volume risks to CONSCO are minimised where appropriate and that usage intensity is minimised in relation to service requirements. BA and POCL will co-operate with each other in respect of communications with CONSCO, but having due regard for our respective commercial confidentiality.

38. The concept behind both sets of contractual factors is to aim towards an equitable and fair price that is commensurate with, and provides incentive towards, the respective business case needs of the BA and POCL, and the programme's overall objectives.
39. It is agreed that all post offices will fall under the scope of the automation programme; however, the exact number of counter positions to be covered (and how they will be) is yet to be decided and this decision will be informed by CONSCO proposals.
40. The roll-out of the programme will have regard to maximising the commercial returns for BA and POCL, consistent with the overall programme objectives.

**Technical and Service Delivery Issues**

41. Both BA and POCL will ensure that proposals from CONSCO are implemented in a way that is consistent with their respective information systems strategies (but not necessarily to pre-determined standards for IT).





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42. Both during the procurement process, and during its implementation, BA and POCL are committed to pursuing opportunities in areas which the procurement either will, or may in part, enable. This may lead to other investments, procurements or improvement projects for directly or indirectly associated processes, either by CONSCO or other appropriate future suppliers. BA and POCL commit to apply security and service delivery standards as agreed to all new services.
43. BA and POCL will co-operate to ensure that the card system of benefit payment is fully implemented, phasing out the existing order book, at the earliest possible date. This will need to have particular reference to early achievement of savings, costs, customer acceptability and operational feasibility.
44. It is BA's intention to transfer benefit payments currently paid by cashcheque at post offices to the new automated system as quickly as possible. BA and POCL will co-operate to ensure the smooth phasing out of the current cash cheque method of paying benefits at post offices at the earliest possible date with full and proper regard to the existing contracts with Girobank.
45. BA and POCL will continue to co-operate on interim measures to reduce instrument of payment fraud, including the constructive consideration of proposals from suppliers.



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46. BA and POCL will co-operate to ensure regular and joint review of the programme to identify areas of risk to the programme in its development, implementation and operational stages.
47. BA and POCL will seek to ensure that arrangements are in place to enable full and proper inspection and audit arrangements during the programme's development, implementation and operation to secure the delivery of the programme's objectives.

**Way Forward**

48. For evaluation purposes of CONSCO, BA and POCL will agree criteria which have regard to the objectives at paragraphs 4 and 5 above.
49. This document will be the basis for further discussion and negotiations, leading to the contracts involving BA, POCL and CONSCO as described in it, during the CONSCO proposal and negotiation phase of the programme.

Signed and Dated:

\_\_\_\_\_  
For Benefits Agency

\_\_\_\_\_  
for Post Office Counters Ltd

\_\_\_\_\_  
For Social Security  
Agency



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**RESTRICTED - COMMERCIAL****ANNEX 1****BA OBJECTIVES**

The automation of the benefits payment service through post offices is seen as a major element in the re-engineering of the overall administrative processes and the attainment of the BA Business Vision. All objectives will embrace that Vision and in particular the payment system through post offices will:

- (a) provide a method of payment which ensures payment of the right money, to the right person at the right time;
- (b) provide a fully secure system that eliminates fraud as far as possible and controls residual liabilities;
- (c) provide improved systems to detect and monitor unauthorised activity and supply evidence to support prosecution of illegal action;
- (d) provide full accounting and reconciliation facilities;
- (e) reduce current administration costs, secure the lowest value for money cost for the provision of the new service and provide for continuous improvement in value for money throughout the period of the contract;
- (f) provide an efficient customer service which is accepted and understood by them, BA staff and POCL agents and staff;
- (g) provide flexibility to cope readily with any future changes affecting benefits or customer base and to adapt to developing needs of customer service, accounting or security;
- (h) be consistent with the Government's aim of encouraging the use of automated credit transfer (ACT) on a voluntary basis while continuing to provide the option of payment at a post office for those who prefer it.
- (i) enable all of a person's benefit entitlement(s), to be paid in one transaction using a single token or card for the identification of all benefits;
- (j) ensure that any token or card identification system can migrate to a multi-purpose smart card;



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**ANNEX 1**

**BA OBJECTIVES (contd)**

- (k) encourage the use of the National Insurance Number (NINO) as the prime reference number for communications between the BA and its customers, their employers, or other Government Agencies;
- (l) use IT systems that are robust, as far as possible already proven, and secure against fraud, unauthorised access and disasters, are capable of development and interface with existing systems.





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**RESTRICTED - COMMERCIAL****ANNEX 2****POCL OBJECTIVES**

The POCL objectives can be summarised as follows:

- (a) to provide continued customer choice of services available at post offices and be acceptable to customers;
- (b) to retain and strengthen POCL's clear branding links with its customers;
- (c) to maintain POCL's customer base;
- (d) to support government policy of a nation-wide network of post offices;
- (e) to be capable of introduction in all post offices;
- (f) to retain and enhance POCL's commercial and financial integrity;
- (g) to improve overall efficiency and cost effectiveness for POCL and its clients;
- (h) to support and help agents in the development of their private business;
- (i) to be acceptable to staff and agents;
- (j) to facilitate automation of other areas of POCL infrastructure, eg accounting and distribution, and support wider business information needs;
- (k) to retain and gain new business by improving quality of service to all clients;
- (l) to provide the flexibility to meet a diverse range of existing and potential client needs and applications;
- (m) to provide long term stability for the Post Office network as a retail outlet for benefit payments;
- (n) to adopt a flexible and efficient approach to IT systems and adhere to industry standards so as to secure the benefits of development in IT and retail sectors, thereby achieving value for money and faster delivery of new products and services;



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**ANNEX 2**

**POCL OBJECTIVES (contd)**

- (o) to retain customers' trust in the integrity of POCL and improve the quality of service to customers;
- (p) to facilitate the provision of added value services, eg card and/or token issue and management, which will enhance POCL's service offering;
- (q) to ensure the migration of appropriate automated systems without any reduction in service levels;
- (r) to be a key enabler in helping improve POCL's competitiveness, in meeting its business partners' needs, and enhancing future business viability.

These factors should be read in conjunction with the details set out in the prospectus information pack.



**RESTRICTED - COMMERCIAL****ANNEX 3****ANTICIPATED LEADING AUTHORITY FOR BA/POCL AUTOMATION CONTRACTS**

| <b>Activity</b>                                                                 | <b>Supplier</b> | <b>Contracted to</b> | <b>Consequential Issues</b>                                      |
|---------------------------------------------------------------------------------|-----------------|----------------------|------------------------------------------------------------------|
| CAPS                                                                            | ITSA            | BA                   | { Both principals and<br>{ CONSCO need to be                     |
| TIP                                                                             | POCL            | POCL                 | { assured of inputs/<br>{ outputs, not rights<br>{ of inspection |
| CMS (benefits)                                                                  | CONSCO          | BA                   | POCL to have a right to agreed security and service standards    |
| PAS                                                                             | CONSCO          | BA                   | POCL to have a right to agreed security and service standards    |
| CMS (other cards)                                                               | CONSCO          | POCL                 | BA to have a right to agreed security standards                  |
| POCL - Strategic Infrastructure (TMS, Counters Interface, Oper' Supp' Services) | CONSCO          | POCL                 | BA to have a right to agreed security and service standards      |

**NETWORK MANAGEMENT**

|                                            |        |                   |                                                   |
|--------------------------------------------|--------|-------------------|---------------------------------------------------|
| CAPS-CMS,<br>CAPS-PAS,<br>CMS-PAS, CMS-DOs | CONSCO | BA                | POCL to have a right to agreed security standards |
| CMS-POs,<br>PAS-TMS                        | CONSCO | BA and/or<br>POCL | Depends on who is assigned the lead role          |
| TMS-POs                                    | CONSCO | POCL              | BA to have a right to agreed security standards   |
| OTHER<br>LINKED POCL SYSTEMS               | CONSCO | POCL              | BA to have a right to agreed security standards.  |



**RESTRICTED - COMMERCIAL****ANNEX 4****Assumptions in the Illustrative Spreadsheet**

The spreadsheet assumes:-

- **RPI:**

That RPI increases by 3.4% each year, with a base year of 1994/95.

- **Benefit uprating**

The spreadsheet assumes that benefits are uprated by 3.4% in 1995/96 and 4% in each subsequent year.

- **Volume trends**

The spreadsheet assumes a decrease in the volume of payments, primarily due to combination, of 13.96% by 2002/03, with 5% step changes in each of 1997/98 and 1998/99 and 1% per annum in later years, the 1995/96 base of 850.8m transactions.

- **Value trends**

The spreadsheet assumes that there is no underlying change in the value of benefits paid through post offices.

- **Former girocheques**

In 1994/95 there were 80m girocheques, with a value of £7.5bn. The spreadsheet assumes that 50% of former girocheque payments migrate to the new system in 1997/98 (equivalent to 38m extra transactions on the system in line with 5% volume drop) and the other 50% in 1998/99 (equivalent to 72m extra transactions on the system with a 10% volume drop). No drop in values of girocheques is assumed and values are inflated by 3.4% per annum from 1995/96.





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**RESTRICTED - COMMERCIAL****ANNEX 4 (contd)**

- **Network installation**

The spreadsheet assumed that 33.3% of post offices due to be automated are automated by the end of March 1997, 66.7% by the end of March 1998, and all by the end of March 1999.

- **Additional volume-related charge for electronic payments**

The spreadsheet assumes a net additional cost of 2.79p per transaction as a result of introducing the automated system. At this stage, this is purely illustrative of the net effect of changes which might result from the automation of benefit payment. This will include counter transaction time (eg increases due to receipt, printing/signatures at the counter), changes in back-of-office activities related to benefit payments (eg ceased activities such as no longer receiving order books), new/changed activities in outlets (such as enquiries and abortive transactions), and changes in benefit payment related administrative costs elsewhere in POCL.

The table at the end of the spreadsheet shows that with these parameters the 3% floor on year-on-year reductions in the total payable would not be triggered. The table also illustrates the minimum floor levels if the floor provisions had to be applied in every year of the contract from 1996/97 to 2002/03.

