

# **RESTRICTED - COMMERCIAL & POLICY FAX COVER SHEET**

**To:** **Ron Powell**

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**Date:** **19 April 1999**

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**Message:**

**RESTRICTED - COMMERCIAL & POLICY**

To: ~~Secretary of State~~

From: Sarah Graham PFD Sp Proj

Date: 15 April 1999 (Revised 16 April)

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**BA/POCL AUTOMATION PROJECT: TOWARDS AN AGREED MINISTERIAL  
ROUTE FORWARD**

**Issues:**

- (i) Papers you requested following yesterday's discussion on the current position:
- a fuller description of the options B.1.2 and B3 - "the fourth way";
  - a brief account of the position on the project covering the state of the trials and delays;
  - a brief summary of the contractual position in relation to the current trials.
- (ii) Some additional commentary on the current position.

**Note on the attached papers:**

1. We have prepared the attached papers with an eye to the briefing you will need for the meeting scheduled for lunchtime on Monday with your colleagues to decide how best to take the project forward.
2. You may also find it helpful to have in mind your and colleagues' original objectives for the Steve Robson led round of discussions, which can loosely be summarised as follows:
  - to drop the Benefit Payment Card;
  - to move to ACT based payments as quickly as possible, in order to achieve the £400 million administration savings for Government to redirect;

## **RESTRICTED - COMMERCIAL & POLICY**

### **BA/POCL AUTOMATION PROJECT: TAKING FORWARD MINISTERS' PREFERRED OPTION**

#### **OPTION B3/"THE FOURTH WAY"**

##### **Purpose of presenting this option:**

1. This option is a late entrant, devised by DSS/BA a matter of days ago, when it became apparent that the cost of the option being developed so far by Steve Robson with ICL, POCL and ourselves (option B.1.2) was looking so expensive that it could not be acceptable to Ministers.
2. It is an attempt to find a solution which:
  - meets the objectives set by Ministers at the outset of this current round of discussions, and provides something to which all three parties can commit;
  - buys the extra time needed to establish the best value solution for Government, while giving ICL the financial reassurance they need.

##### **Current status:**

3. Because it has been put on the table at the last minute, little detailed work has been possible so far. We are currently trying to engage with POCL to see if there are the bare bones here of a solution that can meet Ministers' objectives. So far they are unwilling to engage. But attempts re being made to get them to work on it, both by Steve Robson and by Alastair McDonald (the G2 at DTI).

##### **Description:**

4. Under this option:
  - the Horizon project would be continued, but without the Benefit Payment Card element; this means that the basic automation platform would be introduced throughout the 19,000 Post Offices in the network, along with the Electronic Point of Sale System (EPOS), utility payments and services for other Government departments;
  - on the back of the roll-out of automation to all Post Offices, the current Order Book Control System (OBCS) - bar-coding of Order Books to prevent fraudulent practices - already included in the project and established in the 204 pilot offices - would be extended to give national coverage; this would give ICL around £40 million revenue from DSS; for this money, DSS would be buying

roughly £80 million per annum programme savings though avoiding fraudulent payments, on top of the £60 million the OBCS system is already saving us; and would go 80% of the way to cutting out the total estimated fraud endemic in the paper based methods;

- DSS would continue with the Order Book method of payment (albeit now protected by the OBCS system) until such time as Post Office were ready to deliver cash via bank accounts, as long as this was no later than 2005 –the date current contracts with POCL and ICL terminate;
- POCL to be given six months to settle its strategy for moving to banking services in a way which would enable the collection of benefit cash from Post Offices via bank accounts; options include moving straight to a "network" banking solution (whereby POCL could bid for business to act as service providers/agents for *all* banks); or entering a strategic partnership with one or more banks to open specially badged Post Office accounts with Smartcards;
- once POCL have decided their strategy, they would be given over two years to develop and put in place banking services which customers will want to use; this could involve their ideas for network banking as well as becoming an operator within "LINK" and therefore provide a rationalised and comprehensive UK cash acquisition service for everyone it also allows a SMART card to be introduced for SMART services without any direct link to DSS payment activity;
- DSS would then and in liaison with POCL and the banking industry, be able to market ACT as the norm for benefit payments against a background that modernisation of such payments would be completed by 2005; once voluntary levels of take-up of ACT have been established the DSS would, by open tender, offer to procure services for the remainder, with POCL in a good position to win that business;
- existing contracts between DSS/BA and POCL and Girobank for paper based payments would remain, thus giving POCL a guaranteed level of income (period to be negotiated) before the move to wholesale ACT. Once the move to POCL banking services has begun it will be open to HMT to agree a funding arrangement via DTI to support POCL's overall service;
- by mid 2001 there would no longer be a need for any direct contract between DSS/BA and ICL Pathway;

### **Background:**

5. The context to this option – in other words the reasons why B.1.2 is running into difficulty – is important: we need to address those difficulties as well as Ministers' original objectives. Some of the key difficulties are:

- any strategy that involves POCL entering into some commercial negotiation with a bank or banks requires more time than the six weeks given by the Prime Minister's timetable and the Fujitsu need to report to their Board on 23 April; if we are to seek such a solution – which may well be the best for the Post Office's long term commercial viability and will secure best value for money therefore for government – we need to find a solution that can buy us more time, while giving ICL some financial security and reassurance up front;
- the reason why Option B.1.2 is coming out very expensive is that it is essentially the Benefit Payment Card project in technological design but *with* add-ons (SMARTCARD, "money box" accounts, a banking sub-contractor etc); and *without* the savings to government that might accrue through:
  - drawing in a bank to share in the investment costs of setting up a simple banking system;
  - the benefits that come to government from transferring the risk to banks; and from minimising the development risk by "piggybacking" on existing and generic systems;
  - ICL appear to have added on "availability fee" to their proposal – in reality to recover all their "abortive" investment to date.

#### Assessment of the option:

6. From a Government perspective, this option offers:

##### A. Advantages:

- Allows both public sector parties to achieve their main objectives.
- Gives potential to broker a way forward with ICL Pathway which gives them enough to keep afloat financially and win their commitment.
- Avoids problems with the PAC about justification for high Government expenditure on a failed PFI project.
- Gives the opportunity to direct Government funding to POCL in such a way that it focuses on that part of the network Government wishes to support (ie the rural, outer-city and other isolated offices).
- Provides evidence of a joined-up approach to problem solving.

##### B. Disadvantages/risks:

- All parties get less than their preferred solutions:
  - POCL plans to enhance their existing "banking" business may fail; BUT there is no option that secures a commercially viable future for the Post Office;
  - DSS/BA could in practice be made to continue with paper-based methods via Post Offices for the foreseeable future; BUT, again this could happen under any option, whatever theoretical agreement is reached with Post Office about migrating to ACT;



- ICL could be left with a "break-even" situation, with little potential for winning more business eg through working with POCL as an agent for Government services.
- Little that guarantees *early* implementation for the "Modernising Government" agenda; BUT potential.

7. An assessment of the advantages and disadvantages for the three parties - ICL, POCL and ourselves - is annexed.

SVG  
PFD Special Projects  
15 April 1999

**ANNEX**

**ASSESSMENT OF THE "FOURTH WAY" OPTION FOR THE THREE PARTIES:**

**For ICL:**

**A. Advantages:**

1. On commercials, provides a tangible financial package:
  - a substantial income for the Horizon platform in the early years and the real opportunity to partner POCL in the development of its business;
  - an assured revenue stream (say £40 million p.a.) for providing the OBCS service;
  - the prospect of any early and final settlement of current liabilities to Government.
2. Retains some prospects of additional/longer-term business with POCL:
  - in support of its banking strategy and/or
  - to support SMARTCARD, Government business
3. Simplifies the technological requirements (and issues) significantly.
4. Simplifies the existing tripartite contractual relationship.
5. Supports ICL in working "with the grain" of Government/public sector objectives.

**B. Disadvantages:**

1. Cuts down ICL share in - and payback from - the project significantly, compared with:
  - (a) their original vision of the project;
  - (b) their bid under option B1.2.
2. Commercials need to be fine-tuned to keep ICL a willing partner: danger that litigation could look better for them commercially.

**For POCL:**

**A. Advantages:**

1. Gives them the earliest possible introduction of automation for their network.
2. Gives them a further six month period to decide/more control over the way in which they move towards providing a cash withdrawal service linked to ACT/BACS, in a way which will fit with their longer-term business and commercial strategy.
3. In the interim before they move to this position they will continue to receive guaranteed funding from DSS/BA (c£400 million a year).

**B. Disadvantages:**

1. Will require POCL to move to a banking solution sooner than they would have done under the BPC option/and lose guaranteed DSS funding.
2. May risk losing benefit recipients' "footfall" (through natural drift to payment via ACT) the longer it takes to install suitable banking payment arrangements.
3. Ways of introducing/marketing a Post Office Smartcard would need to be reconsidered.
4. They may not win the DSS open tender for payments to customers who reject ACT.

**For DSS/BA:**

**A. Advantages:**

1. May achieve c£80 million fraud savings earlier than under other options (including BPC).
2. Opportunity to move to 100% payments via ACT/BACS earlier (and certainly no later than) under BPC option (2005-2008); and achieve the £400 million p.a. administration savings for Government to redeploy.
3. Allows us to stop spending money on a product and a project we can no longer justify: there will be no need for a formal direction to our DSS Accounting Officers to continue funding the project; gets us (and the Government) off the hook with the PAC.
4. Cuts us out of the direct contractual relationship with ICL Pathway, except on OBCS.

**B. Disadvantages:**

1. May have to wait longer than we need to move to/reach 100% payments via ACT if POCL need longer to develop banking infrastructure (we could start in April 2001).
2. May be expected to find funding for settlement with ICL Pathway around withdrawal from our contracts in the BPC.



**RESTRICTED – COMMERCIAL AND POLICY****OPTION B1.2****Summary of Option**

1. The Option consists of the use of a POCL Smart Card as the key for a customer to access simple Post Office Accounts (the "moneybox" account). The BA would pay benefits via ACT to BACS as we do at present for those who currently receive their benefit by ACT.
2. The "money box" account would be a simple credit only, non-interest bearing account capable of:
  - receiving benefit payments and certain other deposits in addition;
  - being free of charge to customers;
  - allowing bill payments;
  - offering benefit customers the opportunity to collect cash at Post Offices.
3. These "accounts" do not in themselves provide the ability to migrate into "full" bank accounts. A separate programme is needed to achieve this; and POCL will need to adjust their banking strategy accordingly.
4. ICL/Pathway would be responsible for:-
  - delivery and operating the infrastructure making use of much of the existing Horizon system developed by ICL/Pathway:-
    - the smart card management system;
    - the administration of the accounts (but ICL would contract with a Bank to deliver the latter);
    - developing the link between the Horizon infrastructure and the Bank.
5. Under this option the Benefit Payment Card would be terminated and the BA would have no contractual relationship with ICL. Payment Cards issued to the existing 35,000 customers with the BPC would be withdrawn and order books maintained until the Smart Card system is ready.
6. The Order Book Control Service (OBCS) currently only in operation in the 204 pilot offices would be extended to the whole of the UK. This would involve the bar coding of all orderbooks and is likely to achieve up to 80% of paper based IOP losses.

**Timescales**

7. POCL and ICL believe that the introduction of these accounts and the implementation of the Smart Card could begin in the Summer of 2002. It would be at this point the migration to ACT into these accounts would begin. Roll out should be completed by Summer of 2004.

**Costs**

8. Based on the costings so far this option is significantly more expensive than the BPC

This is because of:-

- the cost of the Smart Card;
- the cost of the banking partner;
- it is essentially the BPC in design but with add-ons.

8. The additional costs take into account all the administration savings from ACT and are being scrutinised further by KPMG and by DTI.

**Assessment of the Option**

9. Many of the pros and cons of the Option are identical to those of Option B3 (the fourth way) and are summarised in the previous Annex. The key differences to all parties are summarised below.

**For ICL**

This is a better Option for ICL than B3 with no additional disadvantages to them over that Option. It is in effect the Benefit Payment Card (BPC) with extra business. The key additional advantages are that it:-

- maximises the use of their existing infrastructure and software;
- gives stronger prospects of additional/longer term business with POCL; and therefore
- offers much better prospects of improving their return on investment

**For POCL**

There are no additional advantages for POCL in this Option when compared with B3 (the "fourth way") but it has the following additional disadvantages:-

- the Post Office accounts will not of themselves be a stepping stone to bank accounts and POCL will need to adjust their strategy for the introduction of banking services; in effect it adds an extra (and costly) step in their strategy to move to providing banking services;
- they may risk losing "footfall" if accounts are much less attractive than other forms of bank accounts;
- commits POCL to an open-ended relationship with ICL.

**For DSS/BA**

There are no additional advantages to the DSS/BA of this option over B3. However it has one important disadvantage:-

- the risk of making the benefit payment business arguably even more dependent on ICL systems and for longer;
- the difficulty of presenting this changes as an advantage for benefit recipients (unlike B3, that could be presented as *increasing* choice of delivery location and services available).

#### **For Government**

There are no additional advantages but there are some key disadvantages:

- It is more expensive than the BPC (because it is in effect the BPC with add ons) and therefore potentially unaffordable;
- does not overtly meet the Government's main policy agenda
  - to meet the Social Exclusion Unit's likely recommendation for Government/the banking sector to encourage wider access for all to *mainstream* banking and financial services;
  - to meet the Modernising Government agenda.

**BA/POCL Programme - Current Status**

1. This note provides a brief summary of progress on the current BA/POCL Programme including:-
  - recent difficulties in testing the next ICL Pathway Software release
  - preparations for the Live Trial for ICL's product
2. There are differences of view between POCL and BA about the completeness of testing and the readiness for Live Trial that are also summarised in this note.

**Testing**

3. Following technical testing of the latest ICL Software New Release 2 (or NR2) four separate Model Office end to end tests have been undertaken. Each of these tests have taken approximately one month to complete. At the end of each run all significant incidents were corrected and proved through "target" testing. In theory the next Model Office test should have produced a relatively clean run. However, in practice, each of the subsequent Model Office tests has raised as many new incidents as generated through the previous runs.
4. Initial test runs of the software should have been completed by mid December 1998, but because of the above problems testing was halted for two months whilst ICL took steps to put right large numbers of major faults. This was overseen by POCL.
5. As we entered the formal and what should have been the final Model Office run in Feb/March we made it known to the Horizon team our considerable concerns about the creation of new incidents and gave a view that it might be necessary to have an additional run of Model Office. In the event a further 200+ new faults were identified. Some of these were critical and would directly affect the correct or timely payment of 1% of benefit payments in a Live Environment.
6. Further targeting testing has taken place to fix all major faults identified but to date we have not seen a clean run of Model Office. Our definition of a clean run has been set at no incidents which would provide incorrect or delayed payments and only a modest number of background system problems.
7. POCL have rejected that view arguing that the targeted tests have dealt with all known faults, further tests will be costly and will delay the start of the Live Trial and National Roll Out.
8. The BA view is that only with a further run of testing of the end to end system will give the level of assurance needed that no major new faults will be uncovered because this could:-
  - put benefit payments to 60,000 Child Benefit customers at risk during the Live Trial;
  - put at risk the accurate payment of over £1m per week to those customers during the Trial Period;
  - puts at risk the successful completion of the Live Trial; or
  - create a situation in which we had to terminate the Project because of failures of the software during the Live Trial that could have been identified earlier in testing.



9. The differences of view between POCL and BA remain with further discussions taking place to try to reconcile the two views. In the mean time, rather than hold up the Programme, the BA have agreed not to stand in the way of preparations for the Live Trial.
10. The next crucial point in the Programme is on 9 May. By then we will have to have resolved our differences, or found an alternative way forward or risk delaying the Live Trial.

#### **Live Trial**

11. The Live Trial is due to begin on 10 May. This will involve the authorisation of a further 100 Post Offices bringing the total to 304. It will also include the implementation of NR2 into all 304 Post Offices involving approximately 60,000 Child Benefit customers receiving their benefit by card payment.
12. NR2 has new benefit payment functionality including most critically mechanisms for making payments to customers in the event of systems failures. However the major new part of the software provides Electronic Point of Sale facilities.
13. The trial period is for 15 weeks when the software will be monitored closely. At the conclusion of the trial period POCL and BA will need to decide whether to terminate the Project or accept ICL's product and begin to roll it out to all 19,000 Post Offices and all Child Benefit customers not paid by ACT. Roll out is scheduled to begin at the end of August 1999.
14. A meeting took place on 7 April to give approval to proceed to the Live Trial but BA were unable to give approval in view of the current status of testing.

#### **Ramifications of Not Proceeding to Live Trial**

15. If BA continue to withhold approval to proceed the possible implications include:-
  - delays to the Programme (at least 2 months on the start of the Live Trial and 6 months delay to National Roll Out to avoid the periods over Christmas and the Millennium);
  - further adverse publicity about the Programme;
  - lobbying from Sub Postmasters;
  - Press speculation;
  - possible litigation by ICL.

#### **Next Steps**

16. Our legal and contractual position is set out in a separate memorandum from the joint Programme Lawyer Hamish Sandison. In the mean time further discussions with POCL are planned to see if we can resolve our differences or whether we can obtain the assurance about NR2 that we have been seeking.
17. We will report on the outcome of these discussions. In the meantime progress on the Project continues.