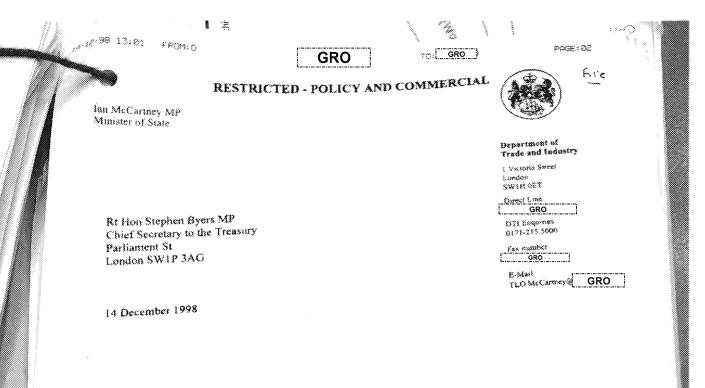
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BA/POCL AUTOMATION PROJECT: HORIZON

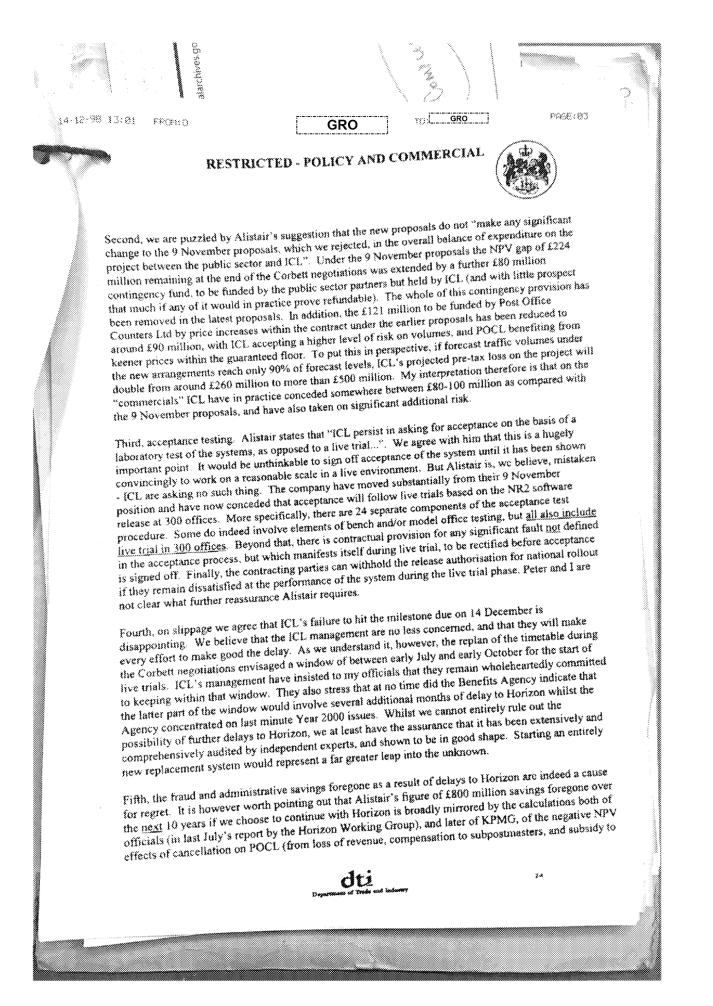
I am grateful to Alistair Darling for copying to Peter Mandelson and myself his letter to you dated 11 December, in which he set out his initial reactions to the latest ICL proposals. I have discussed the letter with Peter, and he has agreed that I should write in the following terms, as our own initial reactions differ substantially on a number of points. You have also seen the Post Office Chairman's letter to Peter setting out the Post Office's reactions.

Overall, Peter and I believe that ICL have now made a major move towards our position which in all key elements genuinely represents their last and best offer, at least on the main elements. Although their proposals still fall some way short of meeting our demands in full, we believe that they nevertheless lay the foundations for a commercially acceptable basis on which to take the project

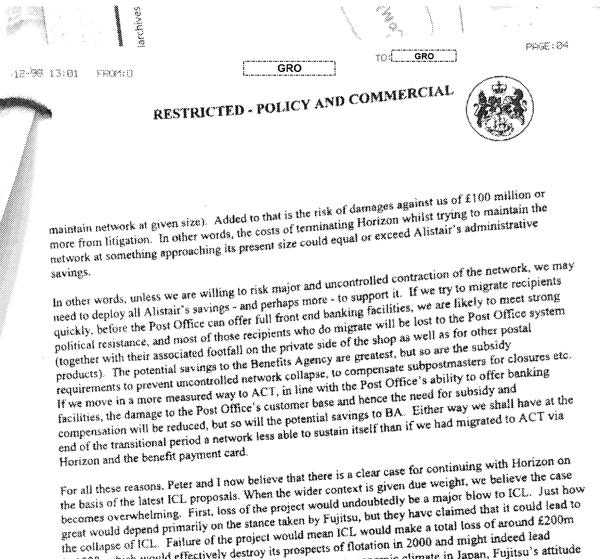
Taking Alistair's points in turn, our understanding is that Fujitsu are indeed willing to back their commitment to stand behind the project to the tune of some £600 million with legally enforceable performance and funding guarantees, in exactly the same way as they have done for my own Department's recently awarded Elgar contract. If this is correct, as we believe it to be, it transfers from the public sector and onto Fujitsu several hundred million pounds worth of risk, represents a major concession on Fujitsu's part from their previous position, and removes at a stroke probably the largest single element of unacceptability from the earlier proposals.



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the collapse of ICL. Faiture of the project would mean recentee in 2000 and might indeed lead in 1998; which would effectively destroy its prospects of flotation in 2000 and might indeed lead Fujitsu to divest itself of the company. Given the current economic climate in Japan, Fujitsu's attitude may well have hardened. Even on a "least bad" scenario, cancellation would badly damage ICL's reputation both here and in export markets, and its future prospects.

It is clear from the recent approach from Mr Naruto, Vice Chairman of Fujitsu and Chairman of ICL, to our Ambassador in Tokyo, Sir David Wright, that cancellation would have a serious effect on our relations with Fujitsu. Sir David does not doubt it. Fujitsu have been a major inward investor in the UK, with well over £700 million invested in the last decade. Whatever the justification from where we sit, cancellation would be seen in Tokyo as a major breach of faith by the UK Government - a withdrawal from the project because we had changed our minds on the policy but had sought to put the blame on ICL. We could expect wider repercussions on inward investment from Japan as Fujitsu's story permeated other boardrooms.

Finally, cancellation would clearly damage the credibility of the PFI process generally, but particularly could be expected to make the funding of future large IT projects on a public/private partnership more difficult to put together. Interestingly, the PFI funding arrangements for Horizon have been portrayed as a model for Japan and heavily promoted as such by Fujitsu's Vice Chairman.



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