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DEPARTMENT OF SOCIAL SECURITY

Richmond House, 79 Whitehall, London SW1A 2NS
Telephone **GRO**

From the Secretary of State for Social Security

RESTRICTED COMMERCIALThe Rt Hon Stephen Byers MP
Chief Secretary to the Treasury
Parliament Street
London SW1P 3AG

16 December 1998

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BA/POCL AUTOMATION PROJECT

I have seen the letter that Peter has sent to you today about the seeming impasse that we reached in our discussions on Monday evening. I believe there is, however, a way forward which can meet all our objectives.

I believe we are all agreed that what we are trying to achieve is a solution which:

- protects a National Post Office network, preferably in a way that encourages the Post Offices of particular value to local communities and Government to stay open; and maximises the potential commercial viability of Post Office Counters Ltd;
- allows us to move as swiftly as possible to a simple, secure and cheap way of paying benefits in a way which will suit people over the next decade; and achieve for Government the potential £400 million a year administration savings in the Welfare Bill for re-direction elsewhere;



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- helps sustain ICL as a major player in the UK IT sector, and ensure that our good relations with Fujitsu - and the Japanese investment market generally - are maintained.

For the past year, we have been striving for a solution which ensures that no one interest is sacrificed in order to achieve the objectives of another. By definition, this will require some compromise on everyone's part. Equally, our final solution should not require one party's interest to be totally subordinated to another - a sure-fire recipe for disaster.

If I have read Peter's letter correctly, there is much common ground between us on the fundamentals. I share his concern to protect a Post Office network, responsive to the needs of the communities they serve, as well as for wider Government reasons; I must also support his view of the best interests of British business, in seeking to support ICL as a thriving and effective player in the UK IT business sector. I cannot accept, however, that the price for supporting those objectives must be that we spend £4 billion pounds over the next decade on a project at the heart of which is a product - the Benefit Payment Card - we do not now want (given the delays resulting from ICL's failure to deliver) and has no value to ICL at its conclusion.

The outcome I believe we should be driving to achieve is therefore one which sustains the project, re-affirming our commitment to ICL; but re-shapes it (within existing contracts) to provide an automation solution which best supports our several interests. As Peter says, a solution which retains the Horizon project and the progress it has already made to automate the Post Office, and builds on its capability to provide banking facilities in Post Offices and other services of potential interest to Government, looks like a solution to which we could all give our clear commitment.

From the ICL perspective, I persist in believing that there are strong advantages for them in engaging with us to re-shape the project with a banking facility, rather than doggedly pursuing the Benefit Payment Card (BPC) element. The Card as a product has no life or market value after our contract with ICL ends.



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It is also as I understand it, as a bespoke and complex system, an element which could contribute to the risks of continuation with the project. A banking facility on the other hand, is something which ICL have already delivered successfully, for example recently for First Direct Bank. It is also relatively cheap and simple to develop; and carries a potential wider market value than the bespoke BPC application. This in turn could well change the balance of risk around the project for ICL; could mean less risk being placed on Fujitsu; and, in turn would reduce the anxiety on ICL's part to tie in Government to very tight terms over the next 10 years - a characteristic of the current proposals for continuation on the table.

These are the positive reasons for the solution that I offer. There are, however, a number of well-rehearsed reasons why I would find it difficult to justify continuing with BPC element of the project, against the background of ICL's failure to deliver. To agree to continuation with the project in full, is in effect using taxpayers' money, voted to the DSS/Benefits Agency, in order to fund a Post Office network. Moreover, this money is used to fund it with "spray-gun" effect, with no ability for Government and taxpayers to influence which offices stay open and which may close - and in practice, those that are closing are often the very ones, in rural or deprived urban areas, which we would like to see supported. This cannot be right or sensible.

DSS Accounting Officers tell me they will need a formal Direction in order to continue with the Benefit Payment Card element of the project: we understand from NAO that to plead wider Government policy interests is unlikely to provide adequate cover for the Accounting Officers, under Parliamentary scrutiny. The Public Accounts Committee in any event has commissioned an NAO VFM enquiry, due to start as soon as we reach a decision about the way forward, and resulting in a formal hearing next Autumn or Spring 2000 at the latest - with the inevitable questioning of the reasons for supporting ICL in the face of its failure, and in all probability against the background of yet further delays to the project. And word has just reached me that the Social Security Select Committee now also wants to look into the project.

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Finally, turning to the specific proposals for continuing with the project put to us by ICL on 9 December, I confirm that they are unacceptable to me. As agreed on Monday, we must for a start ensure that the stated Fujitsu "support" for the project will be translated into legally enforceable guarantees, to cover whatever funding may be required for ICL to meet its commitments over the life of the project - which may be more than the £600 million so far identified. Beyond their promise of "support" from Fujitsu, ICL have not moved significantly since their 9 November proposals, which we firmly rejected. They are still only prepared to carry around £100 million NPV loss, and are expecting the public sector to find more than half the costs of continuation - contributing payments worth a further £230 million NPV over the life of the project. I do not believe this can be justified, against a background of ICL's failure to deliver.

We all agree, I believe, that ICL's proposals to dilute the "acceptance" criteria for the project must be rejected. Nor can they easily be understood, if Fujitsu "guarantees" will indeed underwrite any application to Banks for non-recourse funding - the initial reason given for seeking earlier "acceptance" and concomitant surrender of our termination rights. Certainly, I cannot responsibly accept any dilution in the "acceptance" criteria for the BPC, which would put at risk ensuring that the service provided by the system will work. If the system fails, it will be I and my Department who will be held accountable by the 15 million people who will receive Card payments - many of whom are vulnerable and dependent on benefits for their livelihoods. I am particularly conscious of the risks around "acceptance" criteria from our recent experience with Andersen Consulting on the system for National Insurance contributions (NIRS 2), where an almost identical approach was adopted to that now proposed by ICL. It is a risk I am not prepared to take on the Benefit Payment Card.

I am copying this to the Prime Minister, Peter Mandelson, Jack Cunningham, Ian McCartney and Charlie Falconer.

GRO

ALISTAIR DARLING

