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GRO

BA/POCL AUTOMATION PROJECT;

Further to my letter of 23 April, I am now in a position to let you know Ministers' decision on how to proceed with this project.

Ministers would like to take forward the project in two stages.

- in stage one, the POCL would, subject to agreeing acceptable terms, contract for the supply of the Horizon automation platform, including the EPOS and OBCS systems;
- in parallel with the roll out of stage one, POCL would develop a detailed business plan, so as to establish how best to take forward their long term network banking strategy. The results of this plan would inform stage two of the project in which POCL would contract to procure whatever additional functionality would be required to deliver this business plan. We would expect this work to take approximately three months.

STEVE ROBSON

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From: Geoff Mulgan

Date: 10 May 1999

PRIME MINISTER

cc Jeremy Heywood

David Miliband

Geoffrey Norris

Lord Falconer

HORIZON

1. There is now an impasse over how to proceed in relation to the Horizon project, with a clear divide between Lord Falconer and Stephen Byers who favour proceeding with a smart card system and Alan Milburn and Alastair Darling who favour either a radically scaled down version of Horizon or termination. A decision has to be made by tomorrow morning. The attached notes from Alan Milburn sets out the positions. This note attempts to give you a steer.

Background

2. You will recall that the policy objectives for this project were:

- to protect the Post Office network
- to protect ICL and our relationship with Fujitsu
- to protect the Treasury public spending interest
- to achieve a quick move to ACT
- to achieve modernising government objectives

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3. The Treasury was tasked in December with developing an alternative to the Benefit Payment card, but within the same overall costing envelope. Instead the new proposal that has arisen from negotiations has turned out significantly more expensive. We therefore have three options in play: a new smart card based option (B1); a substantially scaled down version of Horizon, involving ICL (B3); cancellation to be followed by a new contract (C).
4. All involve very substantial costs - £400-500m over the next three years - which will have to be covered by the Treasury. Short-term, cancellation is the most expensive option, mainly because of the likely need to pay off ICL so as to avoid litigation.
5. In the longer term the smart card option, which also involves setting up accounts for all benefit recipients, appears to be considerably more expensive - £300-400m - than the others. However, there are significant doubts about how reliable these figures are:
 - any delay in implementing ACT would substantially increase the cost of the other options. For example if, in the event of cancellation, subpostmasters were to be given an assurance that there would be no move to ACT until 2003, by which time they would have an alternative system in place, the extra cost of B1 falls to £150-250m
 - B1 may bring much higher revenues than the others. The costings are based on POCL's estimate that new revenues deriving from the smart cards will amount to £160m over ten years. ICL estimate these at more like £700m, and

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believe that a more commercially-minded Post Office would be more optimistic. Much will depend on how quickly government implements the various 'modernising government' proposals set out in the White Paper, such as electronic vehicle license applications or change of address facilities.

- while the costs and benefits of B1 depend on whether the flow of new 'modernising government' spending actually materialises, on the capacity of POCL to use the technology well, and on the project not running into further delays, the estimated costs of the other options are even less certain – and could be significant underestimates.
6. On balance our judgement is that it would be wise to assume that there will be a substantial additional cost with B1, probably between £100m and £300m, even if the precise figure is unclear.
 7. The question which then follows is whether what this buys in terms of greater security and stability for the Post Office network, and a vehicle for modernising government, is worth the extra cost.
 8. Treasury, backed by DSS, judge that it is not. They strongly argue against throwing good money after bad. They therefore favour B3 as the least worst option. This is preferable to the government compared to cancellation, mainly because it avoids having to pay off ICL. On paper it looks attractive, as a lower risk, lower reward option. However the Post Office board are adamant that they would prefer cancellation. It would therefore be necessary either to give them a direction or to offer a big financial incentive, probably £100m.

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9. This table summarises the advantages and disadvantages of the three options:

Option	Cost	Policy implications	Risk	Tactics
B1: Horizon plus smart cards	Expensive	More policy gain	Low	Would need to twist GB arm to get HMT agreement
B3: scaled down Horizon	Cheaper	Less gain	Medium	Might need Byers to direct Post Office Board; might in practice lead to C
C: termination	Cheaper (though possibly expensive short-term)	Less gain	Higher short-term, though potential advantage of a fresh start	Strong chance of litigation with ICL

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10. The view of myself and Geoffrey Norris is that, despite its flaws, B1 is on balance just preferable to the alternatives, since it better meets the main policy objectives, avoids political turbulence, and may in the end not cost much more than the alternatives. However, we would recommend that this should only be agreed if the Post Office commit to make a greater contribution to the costs, with at least an additional £100m to cover the funding gap (so far they have promised another £37m).

11. If B1 proves impossible, we agree with the Treasury that B3 is probably preferable to termination. The government would then offer the Post Office a choice between B3 and termination, either with a direction or some financial sweeteners to encourage them to accept B3 (in our view a direction to impose B3 on the Post Office Board would alienate the board and directly contradict the government's promise to give them greater commercial freedom). We would probably then know within a few weeks whether B3 was viable.

12. There is a separate, but important issue, about whether Post Office liberalisation should be delayed to help fund any of these options. Delay would contribute an extra £190m in the first three years. The Treasury will want to use this as an incentive for the Post Office to accept B3. There are strong policy grounds for rejecting this, but it will be hard for No 10 to block unless we can point to an alternative funding source.

That is
a bit
out of
the
white
paper
package

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Presentation

13.If B1 was to be agreed, it could be presented as a major step forward. The government would be doing away with the failed Benefit Payment Card favoured by Peter Lilley, and replacing it with a much more modern Smart Card. It would be providing the basis for a much more aggressively commercial Post Office strategy, and tackling financial exclusion by providing all welfare claimants with a bank account.

14.If B3 or cancellation was agreed, it would be necessary to explain that the Benefit Payment Card had failed, that ICL had failed to meet its deadlines, that the costs had escalated out of control, and that government was putting in place the resources for the Post Office to quickly develop an alternative automation strategy, prior to any move to ACT.

15.What to do next? You have three options as to how to handle this decision:

- To make a judgement yourself on the basis of the admittedly imperfect information at hand, and recognising that there is no objectively correct answer
- To call a meeting first thing tomorrow morning of the relevant ministers (given the complexities involved this would not be a short meeting)
- To nominate someone else to make the judgement on the government's behalf during the course of tomorrow morning

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