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FACSIMILE

cc Peter Schofield
I would welcome
advice on this consulting
DSS & OTT & preferably,
Lawyer

GRO

TO:

Mr. Steve Robson

COMPANY:

H.M. Treasury

FAX NO:

GRO

DATE:

4/3/99

FROM:

Richard Christou

ICL

Tel:

Fax:

GRO

MESSAGE:

Please see the attached

Number of pages including cover

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4th March 1999Fax No. GRO

Mr. Steve Robson,
Second Permanent Secretary
HM Treasury,
Parliament Street,
London.
SW1

WITHOUT PREJUDICE
COMMERCIAL IN CONFIDENCE

ICL

Dear Steve,

I felt we had a useful and constructive meeting on Friday last, and I was delighted at your news that the Prime Minister has given the go-ahead to consider the adoption of either Option A or B. As I told you on the telephone last night, I am very much looking forward to the meeting on Tuesday, under your chairmanship, which I regard as the beginning of a constructive period of engagement that will at last bring matters to a satisfactory conclusion for all concerned.

However, as I also told you, the lack of any tangible, formal commitment is causing ICL, not to mention Keith and myself in particular, considerable difficulty on a number of fronts - with our shareholders, with our bankers and with our auditors.

Fujitsu regard ICL's offer of 18th December 1998 (Option A) as exceedingly generous given their undertaking to provide all of the necessary funding and their agreement that ICL take a substantial loss on the base case. They do not understand why Option A has not, by now, either been definitely accepted or, at least, rejected with some logical explanation as to the reasons for that rejection. With year end and borrowing pressures mounting, they are losing confidence and patience.

The dedicated facility of £250m for financing the Pathway project (guaranteed by Fujitsu) has now been completely drawn down. Keith and I have so far persuaded our board and shareholders that ICL should continue to finance the current needs of the project out of its general working capital facilities, but this will not be feasible for much longer. Further, the dedicated facility is due for review on 31st March 1999, and the bankers concerned are monitoring the current negotiations before deciding their stance. In the event of an unfavourable resolution, or no resolution, they will withdraw the facility and call on Fujitsu to honour its guarantee.

I have already talked with our auditors (Pricewaterhouse Coopers). They are quite clear that, unless a satisfactory solution, which allows the project to continue on a viable basis, is reached by the end of March, they will require a provision to be made against the work in progress in respect of Pathway which is currently carried on our balance sheet. By that time this will amount to something in excess of £250m. If this occurs, ICL will become insolvent unless Fujitsu injects further shareholders funds to pay off the dedicated Pathway facility. In those circumstances the project will terminate and it is inevitable that court proceedings will follow. The matter will then be out of my hands.

(continued... 2)

R Christou
Director

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Merely keeping going without some definite resolution by the end of March, and hoping that things will resolve themselves by some later date is thus not a realistic option. The combined pressure from our shareholders, our bankers and our auditors means that some positive solution (albeit an interim one) has to be found by the end of March if we are to be able to carry on with the project, in whatever form, for the benefit of all parties concerned.

I have been giving serious consideration to the best way to solve what, as I told you on Friday, I regard as our mutual problem, and I am heartened by the fact that you said you would do what you could to help in its resolution.

I am convinced that the key to the solution is to look at matters from the point of view of what will satisfy the auditors. If this can be achieved, then no provision becomes necessary, the pressure point of ICL's insolvency will disappear, and I am confident that both our shareholders and our bankers can be persuaded to give you and me enough time to work through the details of Option B, which I consider, as I know you do, to be the best way forward for the project, provided that we can set a definite end date for that process.

In approaching the problem from the aspect of the auditors, it is first of all important to make you aware that Fujitsu's year end is also 31st March, and that they have a different set of auditors - KPMG. Thus, given the materiality of the amounts at stake even to Fujitsu, any solution will not only have to satisfy ICL's auditors, but will also be exposed to the rigorous scrutiny that KPMG will bring to bear upon it, given that they are acting as the auditors to a very large public company, with all the potential liability for them that that entails.

The first point to make is that confirmation to the auditors (even if backed up by letters from HMG) that negotiations are continuing will not, they tell me, be enough to satisfy them. They will not be convinced even if we embellish this confirmation with statements that we are all confident a satisfactory resolution will be achieved in the near future.

What they require is certainty of one or more outcomes which, on a true and fair view of the situation, will enable ICL to construct a business case which avoids a write off. Clearly, this position could be achieved in a number of ways.

There seem to me to be four possible ways in which the auditors' requirements could be satisfied.

The first, and most practicable and desirable, is the adoption of the new proposal, Option B. There is, I believe, a strengthening view that Option B is the best way forward, notwithstanding the need to specify it more carefully both commercially and technically. We, therefore, as you and I have already discussed, need to give priority to agreeing the details of Option B as soon as possible, including a viable business case which (after taking account of abortive costs, changes to specifications, timescales, development costs and business mix and any other relevant matters) will give ICL the same opportunity over all, neither more nor less, as it would have had if Option A had been accepted.

The second is a decision to take only what I have previously described to you as the core system. In this situation, since there would clearly be much less opportunity for additional business, there would have to be significant adjustments to the ICL business case, if ICL were not to suffer a write off.

what is that?

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The third option is of course to accept Option A, as contained in ICL's offer of 18th December 1998, although, with the passage of time, and the considerations relating to mothballing the benefit payment card, there would clearly have to be adjustments to the programme, contract time scales and ICL's business case, if this were the preferred route. My personal opinion is that, as confidence builds through our discussions on Option B, Option A will drop by the wayside. Nevertheless the concepts of mothballing the benefit payment card and resurrecting Option A, if required, are still certainly feasible.

Finally, the fourth option is termination for convenience. I mention this option only for the sake of completeness, since, although none of the parties are contemplating this, nor do any of us regard this as a desirable or likely outcome, it is currently provided for in the contract, and would afford a method by which ICL could continue the project until discussions are concluded, with the surety that, as a matter of last resort, at least most of its costs would be covered.

To construct a satisfactory solution then, it seems to me that we need to agree the commercial framework and enter into an open, legally binding agreement between all the parties.

My understanding of the proposed commercial framework is that we would develop the scope and commercial arrangements for Option B whilst continuing the preparations to roll out the Core System in accordance with the planned program. We would keep Option A available for a finite period by mothballing the Benefit Payment Card.

The legally binding agreement would therefore be along the following lines:

1. ICL will mothball the benefit payment card immediately.
2. ICL will continue to roll out the core system (ie the system as currently specified without those modules relating to the benefit payment card) to the currently agreed programme time scales.
3. All parties will work as speedily as possible to finalise the technical and commercial details for Option B. This should be achieved by no later than a specified end date. Given the time pressures relating to mothballing, the end of June 1999 seems appropriate.
4. BA/POCL will (subject to 5 below) agree that by the specified end date, at the latest, they will amend the current contract either:
 - (i) to adopt Option B, if agreement has been reached on all the details as provided in 3 above; or
 - (ii) to adopt only the core system, without the benefit payment card; or
 - (iii) to resurrect the benefit payment card from mothballing, and, in effect, to return to Option A.
5. If BA/POCL do not wish to accept any of the three possibilities in 4, by the specified end date, then they will, on that date, terminate the contract for convenience in accordance with its current terms.

Since time is short, I have taken the liberty of fleshing out in an attached appendix some further details of this solution, which should assist in your consideration of the issues that would have to be addressed.

As I told you over the telephone, Keith is going to Tokyo next week, and, so far, has nothing further to tell his shareholder and board members than the statement he gave them at the last board meeting in

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February; namely, that discussions on Option B are continuing in a positive atmosphere. He really needs a letter from HMG to confirm support for an interim solution as described above, by early next week. This will enable him to have a positive meeting in Tokyo and to carry his shareholder with him. This will give you and me the breathing space to achieve the resolution that we both now believe is within our grasp.

I would welcome an early opportunity to discuss the contents of this letter with you in person, once you have had a chance to consider it in detail.

Your sincerely,

GRO

R. Christou

CC: Keith Todd - ICL

Without Prejudice – Commercial in Confidence**Appendix****A. Basic Commercial Framework**

The Parties will agree the scope and appropriate commercial arrangements for Option B. Whilst these discussions are taking place ICL will continue with the preparations to roll out the core system to the agreed program without the Benefit Payment Card (BPC).

ICL will complete any necessary development work on the BPC to ensure that it is 'mothballed' for a defined period. Option A will therefore remain an available option for this defined period.

POCL and ICL will agree a contractual joint venture in relation to pursuing 'Modern Government' opportunities.

HMG will agree by a defined date (no later than 30th June) which Option to pursue.

B. Commercial and Legal Implications

The proposed solution does not require a decision on stopping the BPC by 31st March, but it does require a decision to carry on or to mothball the BPC for a period.

Mothballing the BPC is not a viable option in the long term. The decision on whether to reinstate Option A needs to be taken fairly soon. Our mothballing paper indicated a date of 30th June 1999.

The successful mothballing of BPC is reliant on all parties working together to maintain their respective capabilities with respect to the end to end system.

The mothballing of BPC will delay the introduction of the BPC and will adversely affect the economics of the ICL business case.

C. Contractual Arrangements**1) Option B**

- Agree a procedure and timeframe for completing the development of the scope and commercial arrangements for Option B.
- Agree that all costs in relation to developing Option B should be paid on a time and materials basis.

2) Mothballing the BPC

- Agree the definition and program impact of 'mothballing'.
- Agree the upfront costs of mothballing for the defined period (not later than 30th June 1999). The costs of mothballing until 30th June 1999 are expected to be similar to carrying on with Option A.
- Hold ICL harmless from any liability for failure of POCL or DSS to carry out their obligations in relation to mothballing including the parts of the end to end system for which they are responsible.

3) HMG Decision

- Agree an end date (not later than 30th June) by which HMG must choose to
 - adopt Option B;
 - take core system without BPC;
 - reinstate Option A; or
 - terminate for convenience.

4) Consequences of HMG Decision

a) If Option B adopted

- ICL to receive payments to cover:
 - abortive costs on BPC
 - upfront mothballing costs
 - development costs of Option B on a time and materials basis.
- Adjustment to contract program as appropriate.
- Adjustment to contract pricing to bring ICL's business plan back to 18th December 1998 position including:
 - compensation for lost revenue as a result of program slippage
 - changes in costs and funding
 - effect on POCL/ICL Joint Venture revenues.

b) If Core System without the BPC is taken:-

- ICL to receive payments to cover
 - abortive costs of BPC
 - upfront mothballing costs
 - development costs of Option B.
- Contract pricing structure will need to be considerably adjusted to take into account lost revenues which will include:
 - the loss of BPC revenue

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- the loss of potential upside (in particular the loss of POCL/ICL joint venture revenues)
- the effect on the Post Office footfall

c) If Option A is reinstated

- ICL to receive payments to cover:
 - any incremental costs as a result of mothballing
 - remobilisation costs.
 - Development costs of Option B on a time and materials basis
- Adjustment to contract program to cover slippage caused by mothballing and reinstatement of Option A.
- Adjustment to contract pricing to bring ICL's business plan back to the 18th December 1998 position including
 - compensation for lost revenue as a result of program slippage.
 - effect on POCL/ICL Joint Venture revenues.

d) If termination for Convenience is adopted the current contract provisions would apply.

e) General Consequences

On 31st March the BPC costs will not necessarily be abortive because Option A would remain one of the possible outcomes. A write-off in the 1998-99 Accounts would therefore not necessarily be needed as long as HMG agreed to provide compensation as described above if Option A was subsequently reinstated.