

*Bringing Technology to Post Offices and Benefit Payments***FINAL EVALUATION & SELECTION: FINAL EVALUATION TEAM REPORT**

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Version: Issue 1.0
28 April 1996

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1. INTRODUCTION

1.1. Purpose

1.1.1. This is the final evaluation team report, giving:

- (a) an account of the evaluation process from receipt of tenders on 21 March; and
- (b) the results of the evaluation of the re-tenders submitted on 22 April 1966 in response to the Invitation to Re-tender ('ITR') issued on 16 April.

1.1.2. It is supported by the following:

- (a) contract assurance report (PWKP4-40)
- (b) value factor report (PWKP4-41)
- (c) financial evaluation report (PWKP4-42).

1.1.3. An interim evaluation report (PWKP4-37) was produced in respect of the tenders submitted on 21 March and was supported by an interim financial evaluation report (PWKP4-38). The two papers were considered at the Evaluation Board meeting on 19 April; this paper takes account of comments made at the meeting and since.

1.1.4. The Evaluation Board are invited to consider the Evaluation Team's recommendation and reach a conclusion as to the award of contract.

1.2. Summary of Recommendations

1.2.1. The team **unanimously recommends** that if a contract is awarded, it should be awarded to **Pathway**.

1.3. Structure of Report

1.3.1. Sections 2 to 4 provide an account of the process of evaluating the tenders submitted on 21 March and the re-tenders submitted on 22 April. Section 2 gives a brief background to the evaluation, from the establishment of the shortlist to the issue of the ITT. Section 3 describes the evaluation process up to 16 April, following receipt

of tenders on 21 March. Section 4 describes the work done on receipt of retenders on 22 April.

- 1.3.2. Sections 5 to 8 present the results of the evaluation of the retenders received on 22 April. Sections 5 and 6 provide a summary of the contract assurance and financial evaluation activities, fuller details of which are given in papers PWKP4-40 and PWKP4-42 attached. Section 7 provides an account of the Value Factor assessment (including the assessment conducted after receipt of retenders, detailed in PWKP4-41) and its interaction with the results of the financial evaluation. Section 8 considers two other areas relevant to the evaluation. Section 9 provides an analysis of the whole picture in the form of an account of a discussion by senior members of the Evaluation Team of the main results of the various evaluation activities.

- 1.3.3. Members may find it helpful to have the following papers to hand when reading the report:

PWKP4-5	'Use of Value Factors in final evaluation & selection'
	Version 3.0 dated 30 November 1995
PWKP4-8	'Pre-ITT Hurdles'
	Version 2.0 dated 3 January 1996
PWKP4-9	'Processing tenders: From receipt to award'
	Version 1.0 dated 23 February 1996
PWKP4-4	Principles of Financial Evaluation
	Version 2.1 dated 18 March 1996
PWKP4-23	Financial Evaluation Model
	Version 1.2 dated 20 March 1996
PWKP4-22	Programme Value Factor Assessment - 7 March 1996
	Version 2.3 dated 20 March 1996
PWKP4-33	Programme Value Factor Assessment - 26 March 1996
	Version 2.0 dated 19 April 1996

- 1.3.4. Annex B details the members of the Evaluation Team.

2. BACKGROUND

- 2.1. Following evaluation of responses to the SSR from five bidders, three suppliers were shortlisted in July for demonstrations of their proposed offerings and negotiations leading to agreement of draft contracts.

- Cardlink
 - IBM
 - Pathway
- 2.2. Demonstrations and contract negotiations duly took place between August 1995 and February 1996, and on 29 February ITTs were issued to all three suppliers.
- 2.3. Prior to issue of the ITT (via meetings held on 26 and 28 February), the Evaluation Board had accepted that these suppliers had satisfied the conditions for issue defined in paper PWKP4-8 'Pre-ITT Hurdles'. This paper had been approved by the Procurement Board on 21 December 1995 and lodged with the Programme's lawyers on 3 January, before consideration of the issue began.
- 2.4. The hurdles included the minimum service requirements acceptable to the sponsors, the minimum requirements for partnership with POCL and the development of new business opportunities, sufficient transfer of risk and a number of commercial aspects. A full description of the hurdles is attached as Annex C. Having cleared such hurdles, a supplier cannot be excluded from the competition on the grounds of his performance in these areas unless changes have occurred or new facts come to light which make clearance of all or any of such hurdles no longer possible.
- 2.5. In November 1995 suppliers were informed of the criteria for tender evaluation, and that this would be based on both costs and a number of non-monetary "Value Factors". During the demonstrations and negotiations the Programme assessed each supplier's performance against these Value Factors.
- 2.6. Suppliers' pre-ITT scores against the factors together with the associated rationale were lodged prior to receipt of tenders (PWKP4-22, version 2.3, and associated papers) following review by the Evaluation Board on 14 March, a follow-up meeting on 18 March and subsequent approval by the sponsors' senior Evaluation Board members. (Paras 3.3.6 and 4.2.6 describe the action on Value Factor scores after receipt of tenders and retenders.)

3. EVALUATION OF TENDERS RECEIVED ON 21 MARCH

3.1. Overview

- 3.1.1. The process to be followed from receipt of tenders to award of contract is described in paper PWKP4-9 'Processing tenders: From receipt to award' which was approved by the Procurement Board and lodged with the Programme lawyers prior to receipt of tenders.

3.2. Initial examination of tenders

- 3.2.1. Tenders were received from all three suppliers by the deadline on 21 March. Two suppliers had provided a number of copies with 'blank' prices to facilitate the application of the 'need to know' principle to the evaluation. The third supplier had

not complied with this request, and the prices were therefore blanked out on a number of copies before the tenders were released.

3.2.2. Legal advice was that, given the uncertainty as to the nature of the bids in terms of compliance, no evaluation work should be commenced until the tenders had been reviewed, their categorisation established and a decision taken on the approach. A team consisting of D Miller, R Albright, K Baines and P Elliott (Bird & Bird) and facilitated by D Selwood therefore examined each tender in sufficient detail to establish a prima facie categorisation. Only Baines and Elliott were given access to priced tenders in view of the potential involvement of the other team members in reviewing value factor scores.

3.2.3. The review revealed the following (see Annex D for meaning of tender categories):

<u>Supplier</u>	<u>Claimed category</u>	<u>Actual category</u>
Cardlink	Compliant	Non-compliant - other
Cardlink	Non-compliant - variant	Non-compliant - other
IBM	Non-compliant - variant	Non-compliant - other
Pathway	Compliant	Compliant
Pathway	Non-compliant - variant	Non-compliant - other

3.2.4. Legal advice was that at this stage evaluation should cover either compliant tenders only or all tenders and that the ITT letter allowed either course of action. If it subsequently became clear that, for any reason, a tender could not possibly lead to an award of contract then the evaluation of that tender could stop. Given that only one compliant tender had been received, it was decided by the categorisation team (as in 3.2.2) that the interests of obtaining the benefits of competition were best served by starting evaluation of all tenders.

3.3. Assurance activities

3.3.1. The assurance activities described in PWKP4-9 were carried out, and where appropriate clarification queries were taken up with suppliers after quality assurance of the need for the enquiry by CNT and/or the Procurement Team. The results of the assurance activities are summarised in the following paragraphs.

Technical Assurance

3.3.2. The technical assurance team identified a number of variations between the tenders and the pre-ITT demonstration/solutions activity. None of these were regarded as major issues; some clarifications were necessary and were satisfactorily resolved.

Contracts Assurance

- 3.3.3. Apart from the compliant tender from Pathway, this activity revealed a large number of non-compliances across suppliers. Some were inherent in the nature of claimed variant tenders, but others were outside the scope allowed by the ITT material relating to variants. The non-compliances were noted in readiness for any negotiations with suppliers.

Partnership Assurance

- 3.3.4. The tender material was reviewed against the results of the discussions held with suppliers during the demonstration/negotiation phase. Some differences were found in the degree of commitment given. Some clarifications were raised and satisfactory replies received.

Risk Transfer Assurance

- 3.3.5. This review was conducted by comparison of the tenders with the ITT position. As with Contractual Assurance, a number of changes were noted across suppliers apart from the compliant Pathway tender. Again, some were inherent in the nature of the tenders but others were outside the scope allowed for variants by the ITT. The changes were noted in preparation for any supplier negotiations.

Value Factor Assurance

- 3.3.6. In the course of carrying out the assurance activities the teams noted the need to reassess the pre-ITT scores. Formal reviews at Partnership, Contracts and Demo Stream level were carried out on 25 and 26 March. At the subsequent Programme review on 26 March, the scores and validity markings were amended for a number of factors. The results were documented in PWKP4-33, endorsed by the Evaluation Board on 19 April and taken forward into the evaluation of re-tenders due on 22 April.

Financial Evaluation

- 3.3.7. The suppliers' prices were input to the financial model lodged prior to receipt of tenders and initial runs of the various costing statements produced. In some instances assumptions had to be made because of inadequacies in the information supplied, but these were regarded as providing a sufficient degree of accuracy given the position on the business cases (see para 3.3.8).

Business Case Appraisal

- 3.3.8. The figures emerging from the financial evaluation were input to the BA and POCL business case models. The results showed that both sponsors' business cases were substantially non-viable, and resulted in the presentation to the Sponsor Directors Group meeting described at 3.4.

3.4. Presentations to Sponsors

- 3.4.1. A presentation to sponsor commercial teams had been pre-arranged for 28 March in order to present initial findings and to focus the teams' attention on any new BA/POCL commercial issues thrown up by the nature of the tenders. Very few such issues were identified, and these were of a minor nature. However, it was concluded that there was value in holding the presentation in any event, and in view of the emerging position on the business cases the Sponsor Directors Group ('SDG') agreed that they should also meet that day to receive an abbreviated version of the presentation together with the Programme's proposals on progressing the procurement.
- 3.4.2. The SDG agreed that the Core Negotiating Team ('CNT') should:
- (a) invite all suppliers to identify major cost drivers;
 - (b) negotiate a revised 'package' with each supplier aimed at bringing costs to a level that would make the business cases viable;
 - (c) put the packages to SDG for their agreement in principle;
 - (d) if SDG agreement were forthcoming, invite suppliers to submit revised prices on the basis of their negotiated package; if it were not, then the options of further negotiation or of discontinuing the procurement would need to be considered.

3.5. Negotiations with Suppliers

- 3.5.1. It was agreed that Keith Baines, the head of the financial evaluation team, should be added to the CNT at this stage, given that detailed discussion of the financial aspects of tenders and assessment of the financial impact of prospective changes were to be key elements of the impending negotiating process.
- 3.5.2. All three suppliers were telephoned on 29 March and invited to meetings on 1 April to take forward the remit given to CNT by the SDG. They were told the purpose of the meeting and asked to prepare for it in advance.
- 3.5.3. At the meetings on 1 April the CNT provided initial comments on the tenders and allowed suppliers the opportunity to present the work they had done thus far following the phone calls on 29 March. They were asked to submit the final results of their work by 4 April and were handed a letter summarising the purpose of the meeting and the way ahead. An example of the letter is at Annex E.
- 3.5.4. Submissions were received from all three suppliers on 4 April. After individual consideration of the responses, the Programme Director chaired a CNT meeting on 9 April to determine the negotiating strategy for the impending meetings with suppliers.
- 3.5.5. Meetings were held with suppliers on 10 - 12 April to explore further the responses received on 4 April and to negotiate in principle a package designed to substantially

reduce the service costs to sponsors from those flowing from the tenders lodged on 21 March. Suppliers' considered responses to the points raised in the discussions were received on 15 April.

- 3.5.6. The results of the negotiations, including the responses received on 15 April, were put to SDG on 16 April and their views sought on the acceptability in business terms of the prospective changes. Invitations to retender on the basis of the negotiations, the supplier responses and the SDG decisions were issued to suppliers on 16 April; tenders were required to be submitted by 22 April.

4. EVALUATION OF RE-TENDERS RECEIVED ON 22 APRIL

4.1. Approach taken

- 4.1.1. The ITR letter expressed a strong preference for tenders that were compliant with the revised draft contract that resulted from the negotiations and SDG consideration but allowed one variant bid. For the purpose of the retender a variant bid was any bid which was not compliant, and could include any variant elements the supplier might wish. A commitment was given to evaluate all bids, whether compliant or variant.

- 4.1.2. It had been agreed by the Programme's legal advisors prior to receipt of retenders that, given the terms of the ITR, evaluation should start immediately on all retenders, i.e. there was no need for an initial examination of the kind carried out on the tenders received on 21 March.

- 4.1.3. Retenders were received from all three suppliers on 22 April. All three were variant, displaying varying degrees of non-compliance with the ITR. They were subjected to the process described in PWKP4-9, tailored to the amount and type of information received. Clarifications, where necessary, were sought from suppliers.

- 4.1.4. As a result of one supplier submitting additional, unsolicited information in response to the ITR after the permitted deadline, all suppliers were informed in writing that such information might not be taken into account. Any such "late" information received has not formed part of the evaluation process.

- 4.1.5. Although all retenders contained pricing information, the members of the teams undertaking the Technical, Contracts, Partnership and Value Factor reviews were not exposed to the results of the financial evaluation until they had completed their activities.

4.2. Assurance activities

Technical Assurance

- 4.2.1. This was found to be necessary, given the changes in supplier positions in some areas from their pre-ITR position. No purely technical obstacles to award were found. However, a number of issues were identified for feeding into the Contract Assurance review and the team re-assessed the Demo Stream Value Factor scores (see paras 4.2.6 and 4.2.7).

Contracts Assurance

- 4.2.2. Extensive activity was needed in this area given the number and type of non-compliances across the tenders. A separate report (PWKP4-40) details the results of this review, and a summary is given at section 5. In addition, the team re-visited the Contracts Stream Value Factor scores (see paras 4.2.6 and 4.2.7).

Partnership Assurance

- 4.2.3. This was carried out in parallel with the Contracts Assurance described in para 4.2.2. No changes were identified compared with the position identified previously (described in para 3.3.4).

Financial Evaluation

- 4.2.4. Extensive work was carried out in this area, using the financial models approved prior to tender receipt. A separate report (PWKP4-43) was produced and is summarised in Section 6.

Business case Evaluation

- 4.2.5. The results of the financial evaluation were used to update the BA and POCL business cases. The results of these activities are beyond the scope of this report.

Value Factor Assurance

- 4.2.6. As a result of the findings of the Technical and Contracts assurance activities, both the Contracts and Demo streams wished to re-assess suppliers' scores under the ten non-monetary value factors. The Evaluation Team acknowledged that caveats might be placed on the results, given the exposure of the assessors to pricing information. However, having taken legal advice, it was felt that the degree of new experience and change generated by the negotiations and retenders meant that a re-assessment of the Value Factor scores was essential in order to provide the Evaluation Board with as accurate a picture as possible.
- 4.2.7. The Demo and Contracts Streams held assessment review meetings on 24 and 25 April; the Partnership Stream did not need to revisit its previous assessments. A Programme assessment review was held on 25 April and the results are detailed in PWKP4-41. The scores were input to the evaluation of non-monetary factors described in Section 7.

5. RESULTS OF THE CONTRACT ASSURANCE REVIEW

- 5.1. The full results of this review are set out in PWKP4-40:
- (a) Each retender was compared with the corresponding ITR to establish the degree of compliance. The results were structured around the decisions given by the SDG on 16 April, supplemented by details of non-compliances in areas additional to those considered by SDG.

- (b) given the importance of the **fraud element** a description of each supplier's position was drawn up;
- (c) the other (four) key contractual differences between suppliers were identified - **rebasing volumes at end of year 1, service level remedies, elimination of implied requirements and limits of liability;**
- (d) **non-compliances with the ITR have been costed where possible,** on a basis agreed between the Contracts and Finance teams, but where non-compliances could not be costed, views on the risks to the Contracting Authorities were recorded;
- (e) a summary of the overall Contracts view was produced.

5.2. The principal conclusions of the review are set out below:

- (a) **on fraud,** Pathway represents by far the best value in terms of the scope and breadth of cover for non cardholder verification fraud and its acceptance of some cardholder verification fraud related to the use of extra screens at post office. In addition, it alone accepts the onus of proof and that it is clearly liable for other fraud. The offers from the other two Service Providers are so restrictive in scope and/or liability that they are difficult, if not impossible to accept;
- (b) in terms of the other (four) **key contractual differences,** Pathway are compliant on all four, IBM on three and Cardlink are not compliant on any;
- (c) in terms of **contractual acceptability** against the guidance given by the sponsors, Pathway is a clear winner, with IBM some way behind and Cardlink somewhat further;
- (d) **in terms of award of contract,** Cardlink should not be awarded the contract at any price; Pathway should be preferred to IBM unless IBM's bid offers a considerable price advantage.

6. RESULTS OF THE FINANCIAL EVALUATION

6.1. Introduction

- 6.1.1. This section provides a summary of the results of the financial evaluation documented more fully in the financial evaluation report, paper PWKP4-42, attached. The summary is repeated verbatim in the full report.

6.2. Full Life Costs

- 6.2.1. The results of the relative costs of ownership of the tenders (comprising supplier charges and differential costs attributed to make them comparable) for the best view business workloads are shown in Table 1. These are shown as net present values (NPV) for the life of the contract discounted at 6% and 12% per annum. The table also shows the outline costs, not discounted, for the roll-out and initial Steady State

See Annex for updated version

services (from contract award to February 1999) and the average annual costs for the Steady State services.

Table 1 - Full Life Costs with Best View Workloads

Figures in £m	<i>Cardlink</i>	<i>IBM</i>	<i>Pathway</i>
Full Life Costs: NPV 6%	£1257m	£992m	£1041m
Difference (% of lowest)	27%	0%	5%
Full Life Costs: NPV 12%	£977m	£775m	£819m
Difference (% of lowest)	26%	0%	6%
Roll-out (total of 1996/7 - 1998/9)	£242m	£208m	£238m
Steady State typical year (average 1999/00 - 2004/05)	£237m	£183m	£187m

6.2.2. These figures show that *IBM* and *Pathway* offer substantially lower costs than *Cardlink* at the best view workloads, being around 20-25% less costly. *IBM* is around 5% lower cost than *Pathway*. The difference is less in the steady state than during roll-out, reflecting the fact that *Pathway*'s costs reduce year-on-year in both money and constant price terms, while *IBM*'s money prices increase over the contract due to partial RPI-linking.

6.2.3. Differences in the pricing structure result in a different split of these costs between sponsors as shown in the following table:

Figures in £m	<i>Cardlink</i>	<i>IBM</i>	<i>Pathway</i>
Full Life Costs: NPV 6%			
BA/SSA	847	589	663
POCL	410	404	378
Total	1,257	992	1,041

6.2.4. The next sub-sections drill-down to give explanation of:

- the make-up of supplier charges
- the main attributable costs that have been added to the charges to derive the above NPVs
- sensitivity analyses
- conclusions of the financial evaluation.

6.3. Supplier Charges

6.3.1. All three suppliers have submitted tenders with charging structures based on the common charging mechanism. There are differences in their approaches evident in the differing positions in terms of providing set prices for all or only a proportion of optional and additional transactions and setting caveats against guarantees and transaction volumes.

6.3.2. The NPV of the supplier charges over the life of the contract are shown in Table 2. While these illustrate the payments due to each supplier for the best view workloads, these figures are not directly comparable as different supplier solutions and contract terms have differing associated costs of ownership (discussed in section 6.4. below).

Table 2 - Supplier Charges with Best View Workloads

Figures in £m	Cardlink	IBM	Pathway
Supplier Charges:			
• NPV 6%	1,111	906	904
• NPV 12%	864	708	714

6.3.3. The Cardlink price is subject to significant uncertainty because their tender omitted information on discount bands which is required in order to calculate the price for the option in their tender which is nearest to meeting the sponsor directors' brief for the re-tendering exercise.

6.3.4. To illustrate the composition of the suppliers' charges, Figure 1 shows the total charges for the component services over the life of the contract.

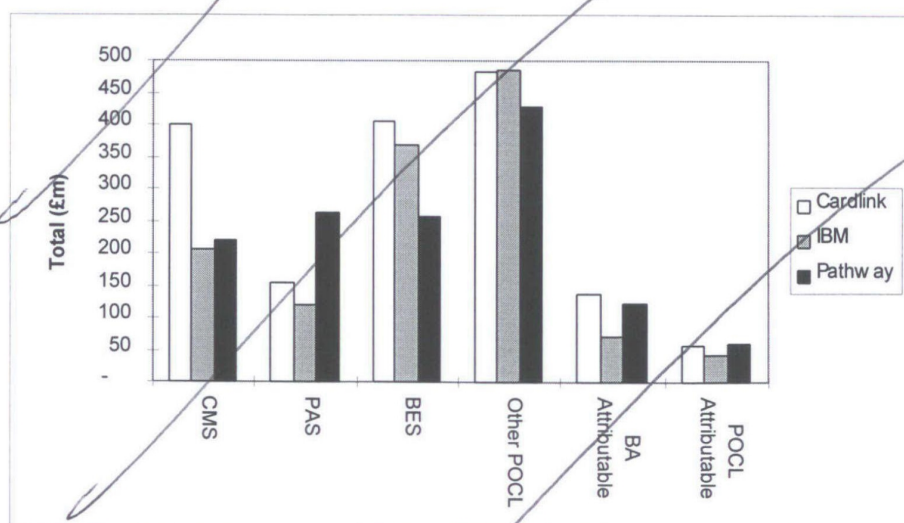


Figure 1 - Composition of Supplier Charges (Average Year)

6.3.5. Although Cardlink's charges are consistently higher than the both of the other suppliers, the higher charges are particularly notable in the Card Management area. Pathway's higher charge for PAS is largely offset by lower charges for BES and this is a result of both a different system architecture and a different approach to allocating cost areas including the premium for fraud risk transfer. This would result in a smaller proportion of BA's total costs being charged via POCL.

6.4. Attributable Costs

6.4.1. The following summarises the attributable costs for each sponsor.

Table 3 - Attributable Costs

Figures in £m		Cardlink	IBM	Pathway
BA & SSA	6% NPV	102	53	91
	12% NPV	78	41	69
POCL	6% NPV	44	33	46
	12% NPV	34	26	36
Total	6% NPV	146	86	136
	12% NPV	112	67	105

6.4.2. The main cost areas included are:

- Card Issue charges omitted from Cardlink's tendered price;
- higher stationery costs of Pathway's solution for benefit receipts;
- higher residual fraud risk for Pathway compared to the other suppliers;
- differences in contracted transaction times, with Pathway's being significantly longer than times they had demonstrated and IBM's being shorter than any they had been able to demonstrate.

6.4.3. These exclude any cost arising from the transfer of the burden of proof of fraud to the authorities in IBM's and Cardlink's bids. It also excludes a possible lower cost option for consumables in Pathway's bid where sourcing benefit receipt stationery under existing BA contracts rather than using the option to purchase it from Pathway could reduce costs by around £6m per annum, equivalent to a reduction of £30m in the 6% NPV and £23m in the 12% NPV of costs.

6.5. Sensitivity Analyses

6.5.1. Sensitivities of the costs to changes in key assumptions have been tested. The following results are worthy of particular attention.

Benefit Transaction Volumes

	<i>Cardlink</i>	<i>IBM</i>	<i>Pathway</i>
10% increase	BA +3.1% POCL -0.5% Overall -1.9%	BA +2.9% POCL -1.6% Overall +1.0%	BA +3.2% POCL -0.7% Overall +1.8%
10% reduction	BA -3.2% POCL +0.5% Overall -2.0%	BA -2.9% POCL +1.7% Overall -1.0%	BA -3.3% POCL +0.7% Overall -1.9%

- 6.5.2. This shows that the variability of IBM's charges with benefit payment volume is around half that of the other two suppliers. This is achieved by setting a discount band break at the guarantee level which achieves a money guarantee of over 90%.

Extent of Automation of Other POCL Transactions

- 6.5.3. If only the Basic POCL transactions were to be implemented, charges would change as follows:

	<i>Cardlink</i>	<i>IBM</i>	<i>Pathway</i>
BA Charges	+0.7%	+0.6%	+0.8%
POCL Charges	-17.75%	-2.01%	-9.91%

- 6.5.4. This again shows the impact of the high revenue guarantee generated by the IBM pricing structure. Achieving the Cardlink price reduction at that level must be doubtful given the condition in their bid which they could use to trigger a review of prices if POCL withdrew any of the Optional transactions from the guarantee, or if volumes of work through the system differed from current forecasts.

POCL Volumes

- 6.5.5. The pattern is similar to BA volume changes, with IBM's prices being significantly less variable than those of the other suppliers. At the low-line forecasts, Pathway and Cardlink total charges would reduce by around 11.5% while IBM's would only be reduced by 5.6%.

BA and POCL Volumes both Reduced.

- 6.5.6. Again, IBM's prices are less variable than those of the other suppliers, also their pricing structure has the notable effect of increasing BA's total charge in these circumstances even though the BA volumes are lower. In this scenario, charges to

BA would reduce by 2% for Cardlink, reduce by 1% for Pathway and increase by 5% for IBM. POCL charges would reduce in all three cases, by 37% for Cardlink, by 35% for Pathway and by 25% for IBM. Overall charges reduce by around 13.5% for Cardlink and Pathway and by 6.7% for IBM.

6.6. Financial Conclusions

6.6.1. The analysis shows that Cardlink are significantly more expensive than the other two suppliers for a service which approximates to sponsors' requirements for the retendering.

6.6.2. On supplier prices, there is little difference between IBM and Pathway. IBM is marginally lower cost at best view volumes but becomes more expensive at lower volumes. Above 110% of best view the IBM price is uncertain as they have not provided pricing information.

6.6.3. The IBM pricing structure achieves an income guarantee for them of over 90%.

6.6.4. IBM has lower attributable costs than the other two suppliers and this makes the total cost of their offer lower than that from Pathway. However, there could be a significant increase in the attributable costs as a result of the shift of burden of proof of fraud to the authorities which is still being investigated, and there are major down-side risks as a result of the lower fraud liability limit and the annual limit of £50m for supplier's liability in the event of complete failure of the service.

6.6.5. Overall, therefore, Pathway and IBM are clearly lower cost options than Cardlink, which is not only the most costly of the offers but also has the highest risks of subsequent cost increases as a result of price review triggers.

6.6.6. Pathway appears to be around 5% more costly than IBM at best view workloads, but there is a greater degree of certainty about the Pathway prices than about those of the other suppliers. Also, the overall cost of the Pathway solution may be reduced by around £6m per annum by alternative sourcing of benefit receipt stationery. This would make it the lowest cost option.

6.6.7. There are significant down-side risks associated with IBM's limits on fraud and general liability. IBM's position relative to Pathway may worsen as a result of additional attributable costs resulting from the changed burden of proof of fraud.

7. THE VALUE ASSESSMENT AND FINANCIAL RESULTS

7.1. Process

7.1.1. The treatment of Value Factors, including the weightings and sensitivity analyses to be applied to the scores in the evaluation, is described in paper PWKP4-5, issue 3.0 dated 30 November 1995 'Use of Value Factors in final evaluation & selection'. This paper was agreed by the Procurement Board late last year and lodged the Programme lawyers prior to receipt of tenders.

- 7.1.2. The process of arriving at the Programme scores prior to receipt of tenders is described in paper PWKP4-25 Issue 1.0 dated 11 March 1995 'Supplier scores in respect of Value Factors' approved by the Evaluation Board on 14 March. The pre-tender scores themselves are contained in paper PWKP4-22 Issue 2.3 dated 20 March 'Programme Value Factor Assessment - 7 March 1996' and associated papers.
- 7.1.3. The process for re-assessing the scores after receipt of tenders, together with the resultant scores, was as described in paper PWKP4-33 Issue 1.0 dated 11 April 'Programme Value Factor Assessment - 26 March 1996' approved by the Evaluation Board on 19 April.
- 7.1.4. The process for re-assessing the scores after receipt of tenders, together with the results and rationale, is described in paper PWKP4-41 attached.
- 7.1.5. The table below shows the weights which the Procurement Board agreed should be applied to the scores to represent the joint BA/POCL perspective of their importance, together with the agreed 'sensitivity' weights to reflect each sponsor's particular perspective.

	Joint	BA	POCL
Characteristics			
1 Customer Acceptability	30	30	30
7 Flexibility	20	20	20
9 Reliability and Support	20	<u>25</u>	<u>15</u>
6 Innovation	15	<u>10</u>	<u>20</u>
2 Staff / Agent Acceptability	15	15	15
Viability			
3 Fraud-Free Method of Payment	30	30	<u>20</u>
4 Credibility of Delivery	20	20	20
8 Management Capability	20	20	20
5 Start-Up	<u>15</u>	<u>15</u>	<u>25</u>
10 Stability and Coherence	15	15	15

Note: underlined figures denotes changes from joint weights

- 7.2.2. These can also be depicted by means of a 'radar chart'. The optimum result for a supplier is to achieve a large well-rounded shape, i.e. one in the upper reaches of the scores with a degree of consistency throughout:



Figure 2 - Value Factor Assessment

- 7.2.3. Applying the pre-agreed 'overall' weights to the scores gives the results shown below.

	Cardlink	IBM	Pathway
Characteristics	5.4	5.1	5.0
Viability	5.5	5.3	4.1

- 7.2.4. Applying the sensitivity weights to the scores does not change any of the figures in para 7.2.3.

- 7.2.5. The results have been plotted on a grid (Figure 2) as envisaged in PWKP4-5 to identify the suppliers according to their position in the financial evaluation and to show their relative standing in terms of weighted scores against Characteristics and Viability. Thus the identities of the suppliers on the grid are:

- 1 IBM
- 2 Pathway
- 3 Cardlink

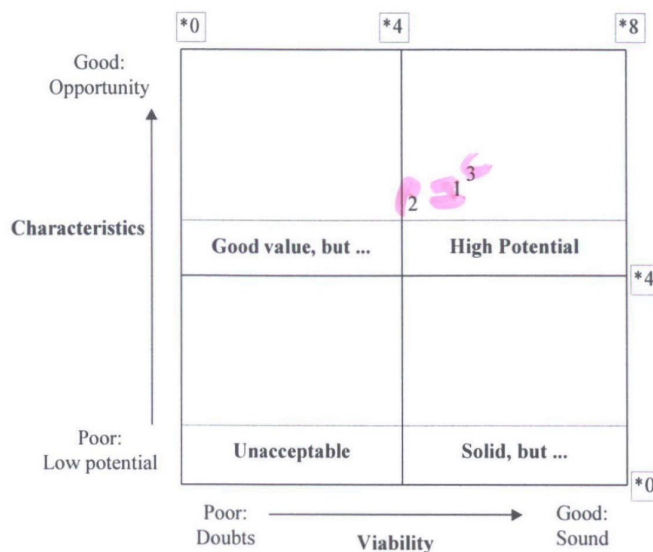


Figure 3 - Value Assessment Grid

8. OTHER AREAS RELEVANT TO THE EVALUATION

8.1. The purpose of this section is to consider two aspects that allow the results of the contract assurance activity, the financial evaluation and the value factor assessment to be considered in their full perspective.

8.1. Risk Transfer

8.1.1. Risk transfer was been considered throughout the evaluation and the results are reflected in the contract assurance, financial and value factor reports. It was also necessary to consider the degree of risk transfer achieved in relation to the acceptability of the prospective contracts in PFI terms. Particular emphasis was placed on the need for confirmation that risk had been transferred in the areas of fraud, commissioning, volume changes and inflation. The assessments below have taken account of discussions with Treasury and the PFI unit in a non-supplier specific environment.

8.1.2. The suppliers' position on five major elements of PFI compliance is summarised in the following table:

PWKP4-43

RESTRICTED - CONTRACTS

also November
[cf Risk Transfer paper]

	Supplier	Cardlink <i>92%</i>	IBM	Pathway
	PFI Compliance Requirement			
1.	Fraud Risk Transfer	Onus of proof on Authorities. No cardholder verification fraud. No cover for unactioned stop notice.	X Tight limit of £10m pa for non cardholder verification fraud. Zero for cardholder verification.	✓
2.	Commissioning Risk in delays etc.	✓	✓	✓
3.	Volume Change Risk	X Requires volume verification at end of year 1 of rollout. <i>92% guarantee</i>	X Requires 92% of revenue to be guaranteed.	✓ Relief for changes to benefit frequency. This is acceptable.
4.	Inflation	X RPI -1% pa offered. Charges will increase	X RPI protected. Charges will increase.	✓ Accept RPI increases up to 6%; share these above 6% with Authorities.
5.	Operate the system to agreed standards	X Limit of £5m pa and £0.5m per single event to penalties for service failure.	✓	✓

PFI-compliant

CITU
expect
substantial
benefit for
industry work

PFI-compliant
 $\leq 80\%$

Singapore

8.1.3. Taking the three suppliers in anticipated order of acceptability:

- It is expected that the prospective deal with Pathway would be regarded as PFI-compliant;
- The position on Cardlink is less clear than that for Pathway, but it is thought probable that PFI compliance would be accepted;
- It is not considered that the IBM deal would be regarded as PFI-compliant, given the company's position on fraud risk, the inbuilt RPI protection mechanism and the high (90%) revenue guarantee.

8.2. Partnership Capability

8.2.1. As mentioned in section 3, the tender material was compared with the commitments obtained at meetings with suppliers last year. In summary, Cardlink's position was unchanged, IBM showed some reduction in commitment and Pathway some improvement in commitment. However, all three suppliers continued to make a satisfactory showing.

8.2.2. The review of the retenders showed no change from this position.

9. ANALYSIS AND CONCLUSION

9.1. The following group, which the evaluation team considered a suitable representation in terms of function and organisation, met on 26 April to consider the results of the evaluation and reach a conclusion:

- | | | |
|-------------------|-----------|--------|
| • Dave Miller | CNT | POCL |
| • Pat Kelsey | CNT | BA/DSS |
| • Robert Albright | CNT | POCL |
| • Tony Johnson | Demo/ | |
| | Technical | BA/DSS |
| • Stuart Riley | Financial | BA |
| • Keith Baines | Financial | POCL |

9.2. It was assisted by:

- | | | |
|-------------------|-------------|-------------|
| • Hamish Sandison | Lawyer | Bird & Bird |
| • Derek Selwood | Facilitator | Kermon |
| • Nick Richardson | Facilitator | Kermon |

9.3. The group considered the results from the various streams of activity feeding into the evaluation:

- (a) the **Contracts Assurance** review ranked the suppliers in the order Pathway, IBM, Cardlink. It considered that Cardlink should not be awarded the contract at any price, because of its unacceptable degree of non-compliance with contract requirements. Pathway should be preferred to IBM unless IBM's bid offered a considerable price advantage.
- (b) the **Financial Evaluation**, having considered both direct and indirect cost implications, had shown IBM with the lowest cost of service but with Pathway sufficiently close for the two to be regarded as virtually equal - both overall and from the standpoint of BA and POCL. Cardlink were significantly more expensive than these two.
- (c) the **Value Factor** re-assessment had shown a close match between the three suppliers in terms of the 'external' factors affecting staff and customers (e.g. customer and staff acceptability), the order within that being Cardlink, IBM and Pathway. On 'internal' factors covering the soundness in terms of service delivery (e.g. stability and coherence, fraud-free method of payment) the order was again Cardlink, IBM and Pathway, with the first two being significantly ahead of the third.

- (d) the **Partnership Assurance** review had concluded that all three suppliers were judged to be satisfactory future partners with POCL in generating new business.
 - (e) the **Risk Transfer Assurance** review had concluded that the deal with Pathway would be regarded as PFI-compliant, that the position of Cardlink was less clear cut but would probably be regarded as acceptable but that the IBM position was thought to be unacceptable in PFI terms.
- 9.4. The group considered that Cardlink should be eliminated from further consideration at this stage. It ranked first on the Value Factors and was thought to be PFI-compliant, but was significantly behind the other two on costs and its bid was regarded by the Contracts Assurance review as one that was unacceptable.
- 9.5. As to IBM and Pathway, IBM's tender showed the lowest cost of service but the two were sufficiently close to be regarded as equal on price. They were virtually equal on the 'external' value factors, but IBM were clearly better on the internal value factors. If these two areas were the only ones to be considered then the balance would be in favour of IBM.
- 9.6. However, there were significant shortcomings in IBM's tender arising from the Contracts and Risk Transfer assurance activities. The Contracts review had recommended that IBM needed a significant cost advantage to be preferred to Pathway, and in doing so had drawn special attention to the IBM stance on fraud risk transfer as being one which had previously been rejected by Sponsor Directors. The Risk Transfer review had concluded that the IBM bid would not be regarded as acceptable in PFI terms.
- 9.7. The group recognised that an award to Pathway would imply a need for a proactive management stance by sponsors, notwithstanding the improvement noted by the Contracts Stream since the restructuring immediately prior to ITT issue. It would also require sponsor staff to work closely with Pathway on fraud prevention measures, although given the changes on fraud risk made by the other two bidders in their retenders most of this work was likely to be required whichever supplier were chosen.
- 9.8. Whilst acknowledging the implications of selecting Pathway, the group considered this a far preferable prospect to the consequences of awarding to IBM (in the unlikely event of their being regarded as PFI-compliant), given IBM's stance on fraud risk transfer and other factors, most notably limited liability.
- 9.9. The group therefore **unanimously concluded** that it should recommend to the Evaluation Board that any contract award should be made **to Pathway**.
10. **RECOMMENDATION**
- 10.1. The team **recommends** to the Evaluation Board that **Pathway** be awarded any contract.

ANNEX A - GLOSSARY

ACT	Automated Credit Transfer
ARTS	Association of Retail Technology Standards (used in context of standard data models for EPOS)
CAPS	Customer Accounting and Payments System
Card authentication	The processes and systems that support the accurate identification of cards.
Cardholder verification	The processes and systems that support the accurate identification of individuals using a card.
CIS	Counter Interface Service
CMS	Card Management Service
ECCO	Electronic Cash Registers at Counters (existing POCL system)
EPOS	Electronic Point of Sale
ESNS	Electronic Stop Notice System, currently provided on ALPS (Automation of London Post Offices)
IPR	Intellectual Property Rights
ITT	Invitation to Tender
OBCS	Order Book Control Service, migrated functionality of ESNS to be provided over the proposed POCL computer infrastructure.
PAS	Payment Authorisation Service
SSR	Statement of Service Requirements
TMS	Transaction Management Service
Watermark	Trademark of Thorn Secure Science (used to support card authentication)

ANNEX B - MEMBERS OF EVALUATION TEAM**Financial**

Stuart Riley	BA/DSS
Keith Baines	POCL
Martin Gill	PA Consulting
Ian Robertson	PA Consulting
Daniel Ratchford	PA Consulting
Guy Pigache	Charterhouse Bank
Trevor Nash	BA
Mick Jeavons	POCL
Marian Ireland	POCL
Bill Lavery	POCL
Martin Vosper	POCL
Stephen Woolley	POCL
Mark Dunkley	BA
Duncan Greer	SSA
Dick Harber	BA
Kevin Lawrence	BA
Hilary Manning	BA
Jan Martin	BA
Brandon Walder	BA

Contracts

Dave Miller	POCL
Pat Kelsey	BA/DSS
Robert Albright	POCL
Hamish Sandison	Bird & Bird
Peter Elliott	Bird & Bird

Technical/Demo/Requirements

Tony Johnson	BA/DSS
Michael Berg	PA Consulting
Colin Oudot	BA
Jeremy Folkes	POCL
Torstein Godesth	POCL

Facilitators

Derek Selwood	Kermon
Michael Purchase	Kermon
Nick Richardson	Kermon
Alan Fowler	Kermon

ANNEX C - DEFINITION OF PRE-ITT HURDLES

The definition is reproduced from paper PWKP4-8, 'Pre-ITT Hurdles'

Any service provider invited to submit a best tender must have cleared a number of "hurdles". The Stage 3 work and the commercial assessments will assess whether the following conditions are met:

(a) Service Requirements

The minimum service requirements acceptable to the sponsors as identified in the requirements catalogue; this includes:

- i. customer acceptability: make sure customers perceive no material worsening in services from POCL; and the new benefit payment service is likely to be acceptable to all customer groups who choose to be paid their benefits at post offices;
- ii. staff / agent acceptability: the services are likely to be acceptable to the system users comprising BA and POCL staff and agents;
- iii. fraud-free method of payment: ensure the services are seen to significantly improve on prevention of fraud and system errors over the existing processes;
- iv. the proposed services meet the minimum requirements specified in the requirements catalogue with respect to robustness, security, transaction process & system response times, reliability and flexibility;
- v. the provision of full accounting reconciliation and audit facilities, consistent with recognised accounting practices;
- vi. the provision of arrangements for making emergency payments in the event of system failure; and ensure the financial impact and speed with which full services are reinstated are acceptable;
- vii. the ability to make one-off payments at short notice (within the service levels specified in the requirements catalogue);
- viii. the capability of the proposed systems (and services) to enable POCL to automate all its clients products and to use automation to develop new services in line with its greater commercial freedom;

- ix. provide for the automation of all post offices in some format, achieving minimum levels of automated business within a reasonable timeframe, ensuring the overall coherence and accountability of post office services;
- x. the service provider has adequate management and technical capability to develop and deliver the proposed services (i.e. there are no major concerns about the viability of the proposed services identified on the SPRR by the Demonstrator).

(b) Partnership

The minimum requirements for partnership with POCL and the development of new business opportunities (as described in the Prospectus and the SSR). This includes ensuring that there are no major concerns relating to:

- i. the ability of the service provider to support POCL in identifying and prioritising automation options following the initial automated transactions;
- ii. the likelihood of the service provider developing a successful commercial relationship with POCL, initially in the role of supplier to POCL with potential to develop closer commercial ties leading to joint ventures if appropriate;
- iii. POCL retaining control of its commercial planning and the products offered at post offices.

(c) Risk Transfer

Sufficient transfer of risk for an acceptable risk profile, in particular for the fraud risks and system errors but also for the general service development, operation and business volume risks;

(d) Commercial Aspects

- i. an acceptable funding method and financial structure;
- ii. acceptable financial guarantees in the event of catastrophic system failure;
- iii. satisfactory termination arrangements that avoid lock-in;
- iv. agreement to a common charging structure;
- v. POCL to retain control of its critical operational processes, and of its key commercial relationships (e.g. clients and agents);
- vi. no material damage to the Post Office brand.

(e) **Service Provider Risk Register**

No Category 'A' risks and an acceptable profile of other risks*.

(f) **Contract**

A draft contract acceptable to BA and POCL*.

* failure to meet any of the conditions (a) to (d) should trigger failure at (e) or (f); however, a supplier passing (a) to (d) but still failing (e) or (f) for some other reason would not receive the ITT

ANNEX D - CATEGORISATION OF TENDERS RECEIVED ON 21 MARCH

A tender was either compliant or non-compliant. There were four categories of tender covered by these two states:

Compliant

A tender which was fully compliant with the ITT and clarifications; the 'baseline bid' referred to in para 3.1 of the ITT letter of 29 February.

Non-compliant - Variant

A tender offering 'risk' variants on the baseline bid. Should conform with the principles of the Common Charging Mechanism but may show the effect on price per servicepoint of variations on the allocation of risk. No limit on the number allowed. Referred to in para 3.2 of the ITT letter.

Non-compliant - Alternative

A tender offering an alternative tariff structure. Maximum of two allowed. Referred to in para 3.3 of the ITT letter.

Non-compliant - Other

A tender which was non-compliant for a reason or reasons other than those specified for the other two non-compliant categories.

Note:

For the purposes of the ITR and retenders, different terminology was used. A retender was either **compliant** with the ITR or **variant** (i.e. not compliant with the ITR).