NFSP00000041

GRO

POST OFFICE

Mr McCartney
Minister of State
Department of Trade and Industry
1 Victoria Street
LONDON
SW1H 0ET

Post Office Counters Ltd

1st July 1999

Dear Mr McCartney

POCL/BA NEGOTIATIONS

At the last Committee meeting you asked us to write to you outlining the position we have reached on the contract negotiations with the Benefits Agency (BA) so that, through contact with Ministerial colleagues, you could seek to resolve the impasse we appear to have reached with BA. A paper on the current position is attached.

As Mena Rego outlined to the Committee on 22nd June, the BA claim that they have a remit from their Minister that sets a strict financial limit on what they can agree with us.

The negotiating brief given to BA by their Minister appears to be based on assumptions provided to KPMG for modelling purposes (independently and in isolation from any discussions with either POCL or ICL). In effect it means the BA team is unable to enter into sensible discussions around commercial terms for:

- OBCS, as they wish to base the price on the old Related Agreements which does not cover the additional costs involved in providing the service under the new contract negotiated by HMT.
- Providing benefit encashment services in post offices until 2005. The BA is seeking to remove the contractual floor immediately, which even KPMG assumed would remain until 2003.

2/..

Post Office Counters Ltd
King Edward Building
King Edward Street
London
EC1A 1AA

Abf(070mr)-01/07/99

Post Office Counters Ltd Registered in England
No. 2154540 Registered Office King Edward Building
King Edward Street London EC1A 1AA

NFSP00000041

Clearly we would not expect you to enter into the detailed negotiations around these issues. What we are hoping you would be able to raise with your ministerial colleagues is the removal of these artificial constraints that have apparently been placed on the BA negotiating team, so we are able to enter into sensible and constructive discussions on appropriate commercial terms both for OBCS and the retention of the contractual floor.

In doing this we would like to assure ministers we are not asking the Department of Social Security to subsidise the Post Office or its network - we are simply seeking a fair apportionment of the costs - as I think the figures in the attached paper demonstrate.

Other issues that are highlighted in the attached paper, which we will clearly be seeking to resolve through the negotiations with BA, include BA's wish to insert new rights of acceptance regarding OBCS from The Post Office. This would mean The Post Office risking having to accept the system from ICL with no assurance of acceptance by BA, or alternatively potentially delaying the Horizon Programme during a separate BA assurance process.

We would be happy to provide further briefing if you require it.

Yours sincerely,

GRO

DAVE MILLER

NFSP00000041

IN STRICTEST COMMERCIAL CONFIDENCE

Benefits Agency Negotiations
Background Briefing

1. The Benefits Agency Negotiating Brief
It would appear that during the course of Government discussions on how the continuation of the Programme should be funded, Treasury sought input from DSS Secretary of State on how much DSS would be prepared to pay. Briefed by his team, on the basis of assumptions it had provided for KPMG modelling purposes (in isolation from any discussions with either Post Office Counters Ltd or ICL) he appears to have proposed the following payments to Post Office Counters Ltd:

	99/00	00/01	01/02	02/03	03/04	04/05
£m	371	395	401	399	333	220

This now has apparently become the BA position in the negotiations, and the BA negotiation team is positioning this as its limit of empowerment.

2. The Post Office's position
The Post Office has a number of issues with the stance BA - and apparently the DSS - are taking.

(i) KPMG made it clear to all parties - including Treasury and DSS - that the outputs of their modelling were only intended to form the basis of a ***value for money*** comparison of the various options put to Ministers. The information used was not based on direct input from all the parties concerned. This means the model does not accurately represent actual cash flows (for example POCL VAT and pre-funding costs are not included in the KPMG assessment).

Indeed, KPMG have noted in the qualifications section of the report that "their work was carried out in isolation from POCL and ICL" and that "POCL's income from BA has been amended to reflect BA's assumptions for payments to POCL" (ie BA determined the figures that they now claim to be the Ministerial remit).

Clearly there was no commercial negotiation around what should be paid for OBCS under the new arrangements. What BA have therefore assumed for OBCS is a price based on the previous contractual arrangements which incorporated the continuation of the payment card.

The pricing proposal we have put to BA now reflects the revised commercial arrangements with ICL.

ii) BA's position is to remove the floor immediately even though the KPMG assumption was that it would go when ACT became compulsory, which

NFSP00000041

KPMG assumed would happen between 2003/4 and 2004/5. Not only is this inconsistent with what BA claim to be is their Ministerial remit (ie KPMG assumptions), but also it would mean BA effectively asking The Post Office to maintain the costs of full provision of Benefit payment services until 2005 without the income to sustain it.

The Post Office is also concerned that the immediate removal of the floor will enable BA to seek product changes that will result in further volume reductions before 2003. This is despite Mr Byers assurances to us that Ministers had agreed there would be no changes to current payment arrangements without our agreement.

We would require a much clearer understanding of BA's plans for ACT and therefore the level of service we would be expected to provide in the two years in question. Without the ability to plan and manage changes to our infrastructure in advance of very significant volume changes, retention of the floor becomes even more critical.

The floor itself was part of a package deal in the last round of contract negotiations and was agreed in exchange for concessions in other areas by The Post Office. It appears BA want to remove floor now because the circumstances it was designed for are now likely to occur as a result of their wish to move to ACT earlier than expected. If the floor is to be removed then this would need to be done in the context of the whole package.

3. Summary of the financial position

In very broad terms the gap between us stands at c £400m. About half of that gap is down to BA seeking to pay an unrealistic price for OBCS. The remaining £200m is down to BA seeking to reduce payments to POCL over the life of the contract by removing the floor in the current contract.

Using KPMG numbers (with all the reservations attached) under Option B3 DSS have incremental savings of c £300m in NPV terms. The Post Office, which has incremental losses of c £600m in NPV terms over the same period, is only seeking c£130 m of those savings, which represents a fair and reasonable price for its services.

BA's position would mean that The Post Office would need to ask its other clients to effectively subsidise DSS as a result of its refusal to pay a fair proportion of Post Office Counters Ltd costs - something which we are not able to do.

4. Further issues

There are a couple of further areas I wish to highlight where I believe it may be helpful to have a wider Ministerial view. We reported on 22nd June 1999, that we were reassured by the agreement between our lead negotiators that;

NFSP00000041

(i) we should work together on acceptance of OBCS in the context of the acceptance regime and time-scales of the current programme. Recent developments with BA on the production of the contract indicate that they are not operating to this principle ie BA have sought to introduce a new schedule into the contract that seeks to impose onerous acceptance conditions on Post Office Counters Ltd. This could in the worst case cause delay to currently tight programme timescales. In addition, the current pricing proposal is based on a service that BA specified and were heavily involved in developing and defining, until they decided to withdraw from the programme. (A copy of our response on acceptance to BA is attached at Annex A.)

(ii) we should only seek to re-open areas of the existing contract directly impacted by the Ministerial decision on the future of the programme. What is clear to us now is that having decided to dispense with the Benefit Payment card, BA is seeking to obtain from OBCS similar levels of product security and risk transfer as they would have enjoyed with the Payment Card. We have pointed out that we can only provide what ICL have been contracted to and have already built. Any changes BA require would have to be introduced within a proper change control environment with costs and service implications fully understood and agreed. Furthermore, BA are seeking to transfer major risks to Post Office Counters Ltd - who cannot lay off the risk to ICL under the agreement brokered by Treasury. These simply place greater obligations on Post Office Counters Ltd and would therefore need to be reflected in an even higher price for OBCS.

5. Conclusion

BA has a very ambitious programme of change to deliver if it is to achieve its ACT ambitions. Getting into entrenched positions on the terms of a contract that is already in place and should have been budgeted for will not be helpful in developing the kind of joint working arrangements that need to be in place to support the delivery of Horizon into the network, prepare the Post Office network to be in the strongest position to face up to the loss of BA business and provide the level and standard of service that BA needs to be in place for payment of benefits in the lead up to ACT.

During discussions BA have continually stated that their Minister is not prepared to fund the Post Office. We in return have made it clear that we are not asking to be funded by DSS but we are seeking a robust commercial arrangement whereby BA pay a fair price for the service we are providing.

NFSP00000041

Annex A.

POST OFFICE

Post Office Counters Ltd

Vince Gaskell
Programme Director
Rm B2506D
DSS
Long Benton
Benton Park Road
Newcastle Upon Tyne
NE98 1YX

25th June 1999

Dear Vince,

Acceptance

Following our discussions on Acceptance on Wednesday 23 June - when I believed we were on the same wavelength - I was not a little surprised to hear from my contract team that we had now received a draft Schedule 16b. This seeks (amongst other things) to impose a full blown Acceptance process on POCL for the OBCS service which effectively replicates and enhances the previous arrangements between POCL and ICL.

Given the stage we are at on Acceptance with ICL, and bearing in mind your own Team's heavy involvement (and Leadership) on the definition and development of the solution as well as the early stages of the Acceptance process, I believed we had agreed that the way forward was to carry on informing and consulting you regarding the OBCS service wherever appropriate.

This was the basis on which our teams met last week and started to develop working arrangements between us that would take us through the very tight time-scales for Acceptance.

In this context the proposed schedule 16b is wholly inappropriate. It would place a heavy resource demand on key staff in POCL to support its requirement at a time when that resource is already fully engaged on the Acceptance of the ICL service and there is absolutely no way that POCL could agree to actions that could result in delaying overall acceptance - as you may realise there is a heavy price tag attached to such a delay under the terms of the new agreement brokered by the Treasury.

Post Office Counters Ltd
King Edward Building
King Edward Street
London
EC1A 1AA

...2/..

NFSP00000041

I am happy for my team to continue to work with your people on the basis that we have previously been discussing and would suggest that this is the most sensible way to go forward. If we attempt to discuss schedule 16b, I am certain we will disagree on many fronts, and this will preclude you from gaining the reassurance you would like on OBCS.

I will be writing further on the other elements of our discussion on the contracts between POCL and BA but I was keen to ensure that there was clarity between us on this particular critical area of activity on the Programme.

Yours sincerely,

GRO

Mena Rego

cc	Sarah Graham	-	DSS
	Ken Davenport	-	BA
	Paul Hanson		