RESTRICTED - POLICY AND COMMERCIAL

To:

SECRETARY OF STATE }separate
MR MCCARTNEY }copies

From:

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18 April 1999

ci: Sir Michael Scholar
Mr Macdonald

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Mrs Britton	PORT
Mr Fraser	IBB
Mr Sklaroff	COM
Mr Hosker	FRM
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Mr Osborne	Legal C
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Mr Leese	PORT
Mr Whitehead	CGBPS 1
Ms Anderson	CGBPS1
Mr Corry	SpAdv
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BA/POCL AUTOMATION PROJECT: HORIZON: MEETING WITH COLLEAGUES 19 APRIL 1999.

1. My submission to you on Friday (16 April) covering the Treasury's draft report by officials to Ministers, and my dissenting DTI text, promised an update once the final version of the report appeared as the basis for your discussion with colleagues tomorrow (19 April, at 12.15).

2. There have been three developments since my submission, all of them reflected in a revised draft (version 3) which emerged late on Friday evening from the Treasury, and which we are faxing to you separately. Treasury officials were hoping to clear this version with the Chief Secretary and Lord Falconer over the weekend, so there may be yet another version at some point on Monday morning, perhaps circulated direct to Ministers' offices.

3. First, **the Treasury have incorporated our dissenting (to termination as the least bad option) text at paragraphs 30 to 36 on pages 8 -9** (our numbering, since the report unhelpfully came with neither page nor paragraph numbering), and have adjusted the remaining text accordingly

4. Second, my note on Friday stated that DSS officials were considering their position. Unfortunately **DSS have decided to support the Treasury in recommending termination** (para 39 on page 10)

5. Third, my submission on Friday made the point that the NPV calculations that show Option B to be £700 million more expensive than Option A take no account of

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the potential which the early provision of a base of some 18 million smartcards in the marketplace should give to POCL to earn commercial revenue (from both public and private sectors), as compared to Option A. I have made this point repeatedly to the Treasury, and asked POCL to work urgently with ICL on at least a preliminary assessment of its potential. The results of this preliminary assessment, carried out with assistance from the Treasury PFI team and CITU, emerged late on Friday and are incorporated at paragraphs 14 -16 of the report - which disingenuously blames POCL for withholding the information! The assessment has identified a potential revenue stream worth £600 -700 million NPV - sufficient to eliminate the gap between this option and Option A.

6. Frankly, this risks moving us from the ridiculous to the sublime, and the Treasury are rightly scepitcal about the deliverability of such an outcome without a separate and substantially enhanced commercial management for POCL. Nevertheless, a combination of at least some significant commercial revenue from the early introduction of the smartcard and a somewhat less pessimistic view on loss of footfall together with a recognition of the wider benefits of this option compared with the benefit payment card and the avoidance of entering a technological cul-de-sac make Option B a much more viable way forward than the earlier Treasury paper suggested. The relative attraction of Option B is likely to be enhanced still further by the apparent recognition by the Treasury on Friday that the true costs of termination are almost certainly substantially higher than has so far been allowed for in the calculations. KPMG are doing further urgent work on this over the weekend.

Conclusion

7. In the light of these latest developments, I suggest that your line with your colleagues tomorrow morning should be to press very strongly for a decision in favour of Option B, recognising the consequential need for some restructuring and strengthening of POCL management; and with Option A as very much a second choice fall back option if it becomes clear that you cannot carry your colleagues with you on Option B. You may need to remind your colleagues that the various remits that have emerged from No 10 since Jeremy Haywood's letter of 14 November last year clearly sought to avoid termination if at all possible, for all the reasons set out in your letter to your colleagues on Friday. Suggested lines to take follow.

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SUGGESTED LINES TO TAKE

- Believe strongly that we now have the basis for a viable way forward with **Option B**. It was always clear that without a revenue stream from the commercial exploitation of the smartcard and the Horizon platform, Option B would appear prohibitively expensive. This potential revenue stream has now been identified, and whilst I agree with Treasury officials that at this stage it needs to be viewed with caution, with a strengthened and restructured POCL management in place there should be scope for the £700 million gap between Options A and B to be narrowed to a much more manageable level. Also believe that the footfall assumptions made for Option B may be unduly pessimistic, which would narrow the gap still further. Avoids the technological cul-de-sac of the benefit payment card, and contributes to wider Government objectives on electronic Government, and possibly on social banking.

- Accept that the history of this project is the most powerful argument against **Option A**. But it is well advanced and technically validated, and carries with it the lowest level of uncertainty of any of the options. It enables BA to move more quickly away from the inefficient and fraud-prone paper-based payment system; gives POCL the modern, on-line platform it so badly needs. There could be rapid migration from the payment card to smartcard enabled access to commercial bank accounts permitting the early move to the payment of benefits by ACT. But this is in my view a second best option.

- I set out in my letter on Friday the substantial damage that I believe **termination** would cause to 18 000 subpostmasters and to the network of post offices, to our wider plans for the Post Office, to ICL and to our relations with Fujitsu. To avoid serious damage to the network of post offices, the move away from existing paper

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based would need to be delayed until the Post Office could equip itself with an alternative technology platform (which might itself suffer the delays which appear endemic in large complex IT projects). Given these very serious downsides, which appear to have been clearly recognised in the remits we have been given by No. 10, and against a background where Option B in particular now offers the basis for a viable way forward for the project, I believe that we should firmly reject termination.

Fallback position on termination

- Termination will cause immense handling difficulties with the subpostmasters (who can expect to find strong support from the Communication Workers Union and the rural lobby - especially against the background of our forthcoming Rural White Paper), and some damage to the network of post offices seems unavoidable. If this is to be minimised it will be essential for us to give an unequivocal public commitment to the subpostmasters and others that there will be no change to the existing paper based methods of payment until such time as the Post Office has been able to equip itself with an alternative integrated on-line IT platform.