

1/05

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MR MCCARTNEY }copies

From:
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DIRECTOR POSTS
GRO

151 Buckingham Palace Road

GRO

1 April 1999

1. Mr Fogg 6/4.
2. Mr. Faint 1/4.
3. Mrs Chisholm/Hle

ci: Sir Michael Scholar
Mr Macdonald
Mr Baker CGBPS
Mrs Britton PORT
Mr Fraser IBB
Mr Sklaroff COM
Mr Hosker FRM
Dr Hopkins CII
Mr Osborne Legal C
Mr Brebner PORT
Mr Leese PORT
Mr Whitehead CGBPS 1
Ms Anderson CGBPS1
Mr Corry SpAdv
Ms Moore SpAdv

BA/POCL AUTOMATION PROJECT: HORIZON: UPDATE

Issue

1.(i) How should you respond to the letter of 30 March from Keith Todd, Managing Director of ICL, threatening withdrawal from the Horizon project unless the Government commits by 31 March to one of the two options favoured by ICL?

(ii) An update on progress towards finding an alternative (to the benefit payment card) way forward with ICL.

Recommendation

2. As a result of yesterday evening's negotiation with ICL, the company's chief negotiator on Horizon, Richard Christou, agreed with Steve Robson that **Keith Todd's letter to you should be set aside and not replied to**. Mr Naruto, Fujitsu Vice Chairman and Chairman of ICL, will instead write next week to the Prime Minister as a precursor to their meeting the following week (12 April). You will recall that you have agreed to meet Keith Todd the following day. **There is no immediate risk that ICL will withdraw unilaterally from the project**. In the meantime intensive negotiations between the two sides will continue, but focusing only on Option B1 as demanded by ICL.

Timing

3. Routine: to note only at this point.

Background

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4. The past few weeks have seen a great deal of intensive effort by POCL, BA, DSS, the Treasury, ICL and ourselves, with help from KPMG and an independent technical expert, to define and cost "Option B" (dumping the benefit payment card and migrating benefit recipients instead to a smartcard-based bank account accessible only at post offices). During this process it emerged that ICL want the bank account to be an electronic moneybox within Horizon for benefit payments only, with ICL managing the smartcard base, since this fits most easily with their existing system configuration and optimises their earnings potential. This version was christened Option B1. POCL on the other hand favour a bank account which resembles a normal commercial account and which they would operate in partnership with one or more commercial banks who would manage the card base, since they see little or no commercial development potential in the ICL version. This POCL version became Option B2. DSS agree with POCL: the ICL version does not match the Government's policy objectives on universal banking.

5. On 30 March Keith Todd wrote to tell you that **working up Option B2 would take too long** (ICL and Fujitsu auditors are pressing for a £300 million provision in this year's accounts, more than sufficient to bring the company down), and that **unless ICL had a decision to proceed with either Option B1, or Option Bzero, by today, he would recommend to the Fujitsu Board that they should pull out of the project and sue to recover the £300 million already spent.** (Option Bzero would roll out - and pay for - the Horizon core infrastructure now, leaving the choice of application options to be made later - but would leave the public sector side in an absurdly vulnerable negotiating position in the subsequent negotiation for the application).

POCL funding

6. We have been pursuing with Treasury and DSS officials the question of **how under Option B POCL should be funded during a transitional period after BA revenue has dried up and whilst commercial opportunities utilising the new Horizon platform are still being developed.** We have a broad measure of agreement that if an acceptable way forward on Option B can be found, Ministers could commit to funding POCL for a transitional period to a level that would ensure that the business would not be materially worse off than it would have been under Option A. We are now working this up in greater detail in a paper for Ministers on funding options. We understand that the Post Office Chairman is likely to write to you next week stressing that the Post Office need to know the Government's intentions on transitional funding before the Board is required to take decisions on any of the options.

Current negotiations

7. At yesterday evening's long and difficult Horizon Working Group meeting which preceded a negotiating session with ICL, Steve Robson insisted - despite strong resistance from POCL and DSS - that the additional work still needed on Option B2

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now ruled it out on timing grounds alone. He accepted that Option Bzero would leave the public sector side unacceptably vulnerable in the subsequent negotiation for the application, and that it should therefore be rejected. **ICL were therefore told that the public sector side was now willing to concentrate on trying to reach early agreement with them solely on the basis of Option B1. There will now be an urgent exploration of the relative costs and merits of the various ways in which this option could be executed.** At its simplest, the benefit account would be accessed by a Post Office smartcard, but in other respects the system would closely mimic that envisaged under the benefit payment card. The accounts held within the Horizon system would be "memorandum" or "virtual" accounts. A more elaborate version of the same option would use, say, Girobank - acting as an agent of ICL, not of the Post Office - to act as the recipient of a BACS (ACT) feed from BA, and might allow the individual accounts a slightly wider range of facilities (for example deposits from other sources). But this version, which would involve cash transfers and deposits, could add to costs and complexity, and reduce the automaticity with which benefit recipients could be migrated from the present paper-based system.

8. There is now intense pressure to reach an agreed way forward (even if it falls a little short of formal heads of agreement) before the meeting with the Prime Minister on 12 April. Two of POCL's main concerns over the next few days will be the level of Government transitional funding they can expect, and the extent of fraud risk they will be expected to take on with or without offsetting compensation.

9. I understand privately from ICL that there will be a Fujitsu main Board meeting on 24 April to sign off the 1998-99 accounts. If there is no solution by that date, there will be, at the insistence of both the Fujitsu and ICL auditors, a provision in the ICL accounts of some £300 million. This will certainly spell the end of the Horizon project, and, entirely possibly, of ICL itself. The next few days will be critical. We will keep you informed of developments.

DAVID SIBBICK