

FA03

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EXTN : GRO
ROOM: 22G

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cc Adam Sharples, Oliver
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BA/POCL AUTOMATION PROJECT

1 This minute addresses three issues what we should be doing to try to stabilise the Horizon programme in the short term to prevent any further deterioration pending Ministers' decisions, whether there is any compromise between Option 1 and Option 2 which might command the support of both BA and POCL, and who the troubleshooter might be

Short term stabilisation measures

2 Our freedom for manoeuvre in the short term is quite limited We cannot implement any steps which prejudice Ministers' decisions Even within this constraint, however, there are things we should consider

- The Panel report has a list of actions which need to be completed by the end of July Some of these presuppose ministerial decisions one way or the other, and will therefore have to be put to one side for the time being (essentially those affecting the "strategic issues"), but many of the actions relating to the critical or operational issues will adversely impact the future timing of the programme if they are not pushed through on a timely basis We need to frogmarch the parties into resolving these issues To encourage them to do so, we discussed a weekly forum to monitor progress This might meet *faute de mieux* under our chairmanship, and might be informed by a hands-on monitoring role on the part of PA I have spoken to Peter Copping about this and he has sent in a proposal, which I attach The price is significant, and we need to consider whether the role represents value-for-money
- Whatever the outcome, we will need more information regarding the build-up of ICL's costs PA do not have the skills required for this task, and it will be necessary to appoint a firm of accountants for the purpose (possibly under the umbrella of the CCTA call-off

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arrangements to save time) The selected firm must have a forensic accounting capability, a good knowledge of IT projects, and a familiarity with the PFI Ross has made initial enquiries through the CCTA which suggest that all the big firms regard themselves as qualified to undertake the work, but there is not one which believes it does not have a conflict We are waiting for capability statements from the firms and can pursue this further once they arrive Subject to finding a firm that can do the work, we need to get cracking on the appointment as a better feel for ICL's costs is going to be essential, whatever the outcome

Is there a half-way house?

3 I was mildly encouraged yesterday by the talk of finding an agreed outcome But it seems clear that BA will not accept Option 1, POCL and ICL are unlikely to accept Option 2, and no one likes Option 3, except possibly the more impetuous at BA So, all in all, the chances of a consensus look small Nonetheless, I think it may be worth considering a half-way house between Options 1 and 2

4 This involves recognising realities The first reality is that BA has the money, and its buy-in is essential It is also the party whose house technically is most obviously in order So any solution we craft must command BA's support

5 The next reality is that, technically speaking, it is possible for POCL to have an agency banking capability installed on the Horizon system from, say, 2001/2 It won't be in a position (probably) to exploit as it will not, by then, have done the necessary deals with the banks and got its own house in order, but no matter It is also clear that there is an unstoppable momentum towards the payment of benefit through ACT, and only a Canute-like settlement would fail to recognise this, and indeed facilitate it

6 The last reality we need to acknowledge is that, however much BA may protest that they never wanted the card and want to get rid of it now, the fact of the matter is that ICL have spent a great deal of money developing the card, the card is a more efficient and economic system for direct encashment than order books, and writing off the development expense will be costly and makes Option 2 doubtful VFM

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7 To find a compromise way forward, I think it essential that we distinguish between technical and financial considerations. We should first identify what seems to us the optimal long-term arrangement for the payment of benefit, and then consider whether there is a financial accommodation available which might secure it.

8 I guess that, approached this way, there would be a broad consensus, probably including even ICL, which would support an outcome which essentially relegated the card to a secondary position, from quite close to the outset. Under this approach BA would be bound to accept the full functionality of the Horizon programme, but would be free from the start to plan an increasing take-up of ACT-fed payments. BA knows that ACT will take a while to ramp up, but they want their way clear to move ahead with ACT. So they should be free to promote increasing penetration of ACT into the cash payment market, but only from the time when, on our best technical advice, a properly resourced organisation in POCL's position might objectively be expected to have been able to deliver a banking platform - ie around 2002. In return, BA must accept that the card will have a long-term role in providing a means of benefit encashment for the cash-minded and unbankable (if we assume that compulsion is not a short-term political option).

9 POCL cannot survive a move to ACT as early as this: it will probably not be ready to compete for BA's ACT business by 2002, and it cannot support the reduction in income it would sustain if the payments to it from BA were reduced to take account of the volume of transactions "lost" to ACT. The second of these objections might be addressed if the guaranteed floor in the existing arrangements with BA continued notwithstanding any move BA made to increase payment through ACT. To the extent that, as a result, BA would be paying twice for the same service, the (beneficial) result would naturally be to drive BA closer to POCL as its preferred supplier of ACT-based payments in order to be able to strike a deal with POCL under which ACT payments would be credited against the floor in determining the overall level of payments to POCL. It might be possible to encourage this process by ratcheting up the incentives on POCL to get ready for ACT by applying a decremental quotient to the tariff of card-based payments, in relation to that part of the market agreed at the outset to represent the target level for ACT payment over the life of the contracts, by including a tariff for ACT-based payments in the contract as part of the present restructuring process and by applying a reciprocal incremental quotient to those payments to maintain POCL's income at steady state assuming that it was able to secure BA's target level of ACT business.

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10 There remains the issue of whether even these incentives would be powerful enough to get POCL to deliver the necessary commercial arrangements with the banks by 2002 or thereabouts. This is bound to continue to be a worry. My instinct is to tell POCL, as part of these arrangements, that they must devolve the Horizon project into a separate subsidiary, allow ICL to take an equity stake and then require both of them together to seek a strategic partner who will help them commercialise the system as a whole.

11 It is going to be necessary as part of a deal like this to give an extension of the present contracts. POCL will need longer-term support as an insurance policy if it loses a significant part of BA's ACT business, notwithstanding all the incentives built into the payment structure and the support of a strategic partner. ICL will need an extension, too, as the risk of a decline in volume of transactions if POCL fails to get a good share of BA's ACT business will directly affect the returns it makes. In addition, it will have unremunerated sunk costs and incremental investment in the banking services platform which it will need to recover to as great an extent as possible.

12 Even this approach may be too difficult to sell to the parties, but I think it may be worth a try. It is the only way I can see of creating a deal BA might possibly want, and this is going to be essential if an agreed solution is going to have any chance of success. If you and Adam think there is anything going for it, we should discuss how it could be sold to BA who should be our first port of call.

Who should be the troubleshooter be?

13 I spoke to Steve Robson about the choice of troubleshooter. His suggestion (which I am ashamed not to have thought of for myself) is Graham Corbett, previously the CFO of Eurotunnel, and a Vice-Chairman of the MMC. Graham has an accountancy background - he was head of KPMG's European practices before joining ET - and has both the knowledge of big projects (although not, so far as I know, in the IT field) and the force of character and stature to knock heads together if the parties are unable to hammer out a detailed commercial solution for themselves once Ministers have signposted the general direction they want to take. Should I ask him to come and see us? - although it may be easier for us to visit him as he is a polio victim and not very mobile.

Adrian Montague