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2) fue BA/POCL

Stephen ST/N
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RESTRICTED - MANAGEMENT & COMMERCIAL

To: 1. Permanent Secretary - as discussed
2. Secretary of State

From: Peter Mathison CE/BA
Date: 28 June 1999

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29/6.

- Copies:
- Ministers
 - Special Adviser
 - Jonathan Tross DCM
 - Paul Gray PG
 - Marilynne Morgan Sol
 - George McCorkell CE/ITSA
 - Stephen Hickey PFD
 - Robert Devereux FSD
 - Sarah Graham PFD Sp Proj
 - Vince Gaskell BA Proj Dir
 - John Codling BA Fin
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 - Pat Kelsey BA Contracts
 - Laurie Cairns PFD Sp Proj

set
30 Jun



Ref: App/June99/doc/MathisonSub.doc
FILE REF: FMP 3C

BA/POCL AUTOMATION PROJECT: FORMAL LAPSE OF TEMPORARY DIRECTIONS

- Issues:**
- (i) formally winding up the arrangements whereby I requested you to issue me with a temporary Direction to continue with the DSS/BA work on the project, for as long as the discussions between the parties to the contracts, commissioned by Ministers, continued; (copy attached);
 - (ii) explaining why no further Direction is now necessary; and
 - (iii) seeking your confirmation that you are content with the position (para 9).

- Timing:**
- Current, to inform:
- our input to the NAO enquiry into the project which is now underway; and also,
 - briefing for the enquiry on BA/POCL recently instigated by the Trade & Industry Committee, before which you have been invited to appear (possibly in week commencing 5 July).

Background:

1. You will recall that on 30 July 1998, you directed me to continue to authorise work to carry forward the development and delivery of the BA/POCL joint automation project, and specifically the Benefit Payment Card element of it, to allow you and your Ministerial colleagues the time you required to take an agreed Government view of the best route forward on the project, given the significant and continuing delays. This against the background that ICL Pathway had been placed in breach of contract by the public sector parties for failure to meet a key operational milestone in November 1997; and that DSS/BA, having subsequently issued a notice of "cure" which expired on 12 August 1998, from that date onwards were in a position where I could have taken steps to terminate the contract and claim damages from ICL for costs suffered by the Department due to the delays. Under the terms of the contract, these would have represented a share of the £200m which both public sector parties were contractually able to claim for ICL Pathway's failure to deliver. The actual (administration) costs to the Department of the delays at that stage were relatively small, given that under the terms of the PFI contract it was ICL Pathway who were responsible for meeting the development costs. However, for each year's delay that the programme was not delivered to plan, there would have been losses incurred through the fraud (programme) savings foregone - in the region of £100m a year.
2. You issued me with a further direction on 15 September 1998, because you and your colleagues had decided to commission some further work on the future of the contracts, and discussions between the three parties to determine if there was a commercially viable way forward which was also acceptable to Government. The drafting of that direction was specifically designed to provide me with the cover I required until such time as a decision was reached. At that point, the Direction would lapse and I, in my position of Chief Executive of the DSS Benefits Agency - and the Permanent Secretary, as Accounting Officer for the Department's overall administration spending - would need to review the situation in the light of the decision taken.

Current position:

3. The decision you and Ministerial colleagues have agreed on the future of the project, announced on 24 May 1999, essentially means that:
 - the temporary direction with which you issued me on 15 September 1998 now lapses;
 - given the nature of that decision, I do not require a fresh direction.
4. The decision you agreed collectively contains the following salient features:
 - the project plans to automate Post Office Counters will continue, with the aim of achieving automation of all offices by end 2001; BUT

- the Benefit Payment Card element of the project is to be concluded;
- DSS Benefits Agency will cancel its contracts with ICL Pathway; and amend its related contracts with POCL;
- DSS/Benefits Agency will move to an ACT-based system of paying benefits as the "norm", starting in 2003 for completion over a two year period by 2005;
- by the same date (i.e. 2003), it is the intention that POCL will have in place the necessary technology and commercial arrangements with banks, that will mean that those people who wish to collect their benefit cash from Post Offices should continue to be able to do so;
- in the interim period, DSS/Benefits Agency intends to tackle the fraud associated with paper-based methods of paying benefits, by extending the use of bar coding Order Books (subject to reaching agreement on commercial terms with POCL); or by similar measures.

5. From the DSS/Benefits Agency perspective, this means that:

- we will not be incurring any future liability or expenditure on the Benefit Payment Card;
- we will only have paid the supplier for services actually provided;
- we have a firm timetable for moving to ACT, making the benefit system more secure against current Instrument of Payment fraud and allowing reconciliation of benefit payment to individual transactions;
- the project is thus considerably simplified and de-risked, so that future plans to replace the current, insecure order book system are not wholly dependent on the automation of the Post Office, and can be regarded as that much more secure;
- there are no costs to this Department for withdrawal from the Benefit Payment Card element of the project, as such, or for payment of what ICL might have claimed were abortive costs for its development;
- although, as stated above, I could have claimed my share of damages that might have been recoverable from ICL for failure to deliver, it is acknowledged and legal advice was formally received to the effect that the outcome of litigation is always messy, uncertain, and protracted, whatever the rights of the case; and against that backdrop to be able to withdraw from the Card with certainty; to have an alternative solution in place - and at no additional cost to what has already been spent by the Department - represents a prudent outcome for this Department's use of public funds.

6. Looking more widely than the narrow Departmental interests to which I am bound to attend under the current accountability rules, I am also aware that the basis on which Ministers took their final decision on the route forward took into account a wider assessment of value for money and policy considerations, including the impact on:

- the 28 million people who use the Post Office network;
- the role of the network itself in the social fabric of the community;

- the individual business prospects of the 17,000 or so sub-post masters who effectively own a significant share of the network;
 - UK Plc; in particular the effect on ICL, as one of the major UK IT players, and on its parent company Fujitsu; and on UK/Japanese relations/inward investment.
7. Ministers also took care to the comparative costs of the policy options they wished to achieve, but against a background where they were obliged to terminate the contracts with ICL and pursue their objectives with another partner. They were satisfied that this would have cost the tax payer more than pursuing the route we have done which provides a final settlement of the past and the future with ICL.

Conclusion:

8. Against this background, I have discussed the current position with the Permanent Secretary, and we are satisfied that neither she nor I need a further direction to continue with the current re-shaped project and plans, which involve continuing with paper-based methods of paying benefits until 2003. This can be justified in terms of:
- our intention to achieve near similar levels of fraud savings as would have been achieved with the Benefit Payment Card by extending the Order Book control system, or other measures;
 - the earlier move now formally agreed to ACT than had hitherto been firm; this will ensure:
 - higher potential savings from cutting out fraud endemic in paper-based methods;
 - significantly larger administration savings than would have been case under the Benefit Payment Card, for the Government to redeploy elsewhere;
 - the ability to reconcile individual benefit transactions;
 - our withdrawal from any direct involvement in the POCL/ICL automation programme, apart from the extension and roll-out of the Order Book Control System.

Next steps:

9. If you are content, the Permanent Secretary will be writing to the Comptroller & Auditor General to confirm the outcome; and to notify him formally of the decision that has been taken and the position on the Directions.

PETER MATHISON
CE BA

Steph to note
GRO
2/15

File: Methods of Payment (UN)
SQ

RESTRICTED - COMMERCIAL & POLICY

To: Secretary of State

From: Sarah Graham PFD Sp Proj

Date: 20 May 1999 [Revised 21 May 1999]

Copies: MoS
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Stephen Hickey PFD
Vince Gaskell BA Proj Dir
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Laurie Cairns PFD Spec Proj
Hamish Sandison Bird & Bird



BA/POCL AUTOMATION PROJECT: TOWARDS MINISTERIAL AGREED DECISION

Issue: Agreement to move forward on a “deal” around option B3.

Timing: Immediate. The objective is to sign the necessary documentation with ICL before 7.00 a.m. tomorrow morning.

Recommendation:

1. That you agree to the proposed “deal”: it meets your fundamental requirements that:
 - DSS move to ACT in 2003 and complete the process by 2005;
 - that DSS are cut out of the funding “loop”.

2. The proposal also avoids the dependency on ICL/risk to us and the public sector of the previous option to introduce special Post Office accounts through which benefits would be paid (option B1); and arguably provides better prospects of certainty for moving to ACT in parallel with Post Office provision of appropriate facilities by 2003, than the termination option – whereby Post Office would have to start their automation process all over again.

Background:

3. You will be aware that we have successfully brokered a deal with ICL around B3 which:
 - costs the Government £10 million less than the estimated costs of terminating the project; and thus meets the Prime Minister's objective to find a way forward defensible before the PAC;
 - meets your and other Ministerial colleagues requirement that ICL will accept liabilities/penalties linked with a fully working system (rather than simply functionality at testing stage);
 - overcomes ICL's requirement (for auditing purposes) that the "deal" should be unconditional, by acceding to their request, **provided** that satisfactory detailed contractual terms can be agreed within three months;
 - should ICL/POCL fail to reach satisfactory contractual arrangements during the three month set period, there will be a termination settlement at POCL's expense (should they walk away) at a fixed price of £150 million: this represents a good outcome for the Government – it provides ICL with some financial reassurance for their auditors; at the same time, it provides much needed reassurance to Government that, if the deal does not work out, there is a certain financial outcome (as opposed to the uncertain and widely variable outcome on termination, if a "deal" fell through, on a range of £0-350 million to Government).

Issues:

4. Our view is that this represents such a good deal for DSS that we do not wish to find problems with it; or if there are problems, we wish to offer a way forward.
5. The key areas where there may be difficulties for us are as follows:
 - we need POCL's written consent to withdraw from the DSS/ICL related agreement with ICL; this should not, in practice, be a problem because in the past POCL have indicated that if Ministers' decision was in favour of the DSS withdrawing from the project, they would not object;

- we need to ensure that there is a firm commitment to move to ACT from April 2003; this appears to be covered in the briefing note that has been forwarded to CST, but we may need to seek further formal reassurance;
 - we need confirmation that the financial arrangements with POCL will be in line with the planning assumptions (and costs) that have previously been provided to HMT and used to model the cost of this option;
 - there needs to be recognition that there will need to be a negotiated settlement between DSS and POCL that may have a financial impact on POCL/the public sector. For example we will need to agree a reasonable price with them for the Order Book Control Service (OBCS) to ensure that it is affordable and that we have a clear business case to justify it. In addition our costings supplied to KPMG and we believe modelled by them, assume the removal of the “floor” payments in 2003. If this is not included there will be additional significant costs loaded on to the DSS in 2003-2005.
7. Against this background, I suggest that in your response to the Chief Secretary you flag up our concerns on funding: my reading is that HMT will be looking to us to absorb our extra costs given that we have done very well out of the “deal”. I have discussed with my opposite number on the public expenditure team at HMT. And the suggested line has been broadly agreed with him.
8. On a different issue, you will know that Stephen Byers/POCL are concerned about the adverse effects “footfall” of this option, and were looking to us to provide some reassurance on marketing of ACT prior to 2003. I suggest it would be helpful to include such reassurance as we can give in your letter.
9. Happy to have a word if that would help.

MRS. SARAH GRAHAM
PFD Special Projects

RESTRICTED - COMMERCIAL & POLICY

**DRAFT LETTER FROM THE SECRETARY OF STATE
TO CST**

BA/POCL AUTOMATION PROJECT

1. I welcome the proposed way forward that has now been brokered with ICL. It is pleasing that after much hard work and effort on the part of all those concerned, we appear to have found a solution that gives the prospect of an outcome to which all parties can commit.
2. As you appreciate, I am able to confirm my support for the proposed way forward because it assures that we move to an ACT based method of payment no later than 2003, completing this process by 2005. I should also like to take this opportunity to confirm that our intention is to achieve this transition with the help of the Post Office, with no prior marketing (unless with their agreement); but on the understanding that they will in parallel and by the same date have achieved suitable facilities to enable our benefit recipients to collect their cash at Post Offices, albeit via ACT/bank accounts.
3. I should also like to take this opportunity to confirm the points I made in my note to you last week, namely that the funding that I require to take forward this option is not covered by the funding I inherited for this project, which was based on completion by 2005 and the achievement of at least £100 million or so programme savings per annum from the end of last year. I should also like to confirm that the funding requirements I set out in that letter, and the estimated savings which could be used to off-set them are based on the assumptions which your officials have been using for planning purposes to estimate the costs of the various options. If those assumptions change, for example because of changes in the level of funding falling on DSS/BA as a result of the detailed contractual discussions, we will need to revisit my funding requirements. You will appreciate, given the wider context of the recent CSR discussions and agreement, that I cannot offer anything further.

Alistair Darling
Secretary of State

Stephen - to note
GRO
24/5

File: BA/POCL
WV
24/5

RESTRICTED - COMMERCIAL & POLICY

To: Rachel Lomax Permanent Secretary
Peter Mathison CE BA
Rod Clark PPS/SoS

From: Sarah Graham PFD Spec Proj

Date: 24 May 1999

- Copies:
- All Ministers
 - Special Advisor
 - Jonathon Tross DCM
 - Paul Gray PG
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 - George McCorkell
 - Stephen Hickey PFD
 - Vince Gaskell BA Proj Dir
 - Ron Powell Sol
 - John Bretherton INF
 - Laurie Cairns PFD Spec Proj
 - Chris Mann BA/CAPS
 - Hamish Sandison Bird & Bird

BA/POCL AUTOMATION PROJECT:

Headline News:

1. The deal around option B3 was eventually agreed at 3.00 a.m. this morning; the formal signing is arranged for 11.00 a.m. today.

Next steps:

2. I will be putting round a fuller note in due course to record the agreement for the record - and, for those of you with a masochistic sense of humour, some of the details of the final toings and froings on Friday and over the weekend!

Summary assessment:

3. As you will be aware, the "deal" is a very good one for us, and gives us our main objectives:
 - an agreed move to ACT;
 - removing DSS from the funding "loop" for taking forward the project;and from a wider Government point of view:

- significantly de-risks the project by scaling it down.
4. But, in contrast to the 1996 situation, it is now POCL who are the unwilling partner in this “deal”, as we will need to be alert to this in our dealings with them:
- we need to be sensitive to their concerns in the welcome we give to the “deal”;
 - in the longer term, and the next stages of the forthcoming negotiation, we will need to help ensure that the “deal” does not in effect get unstitched, for example, by POCL attempting to impose new conditions on ICL or ourselves/the public sector that make the deal unworkable.

Immediate action required today:

5. **Formal signing of the contracts at 11.00 a.m.:** a legal undertaking was given on our behalf by Hamish Sandison to the ICL lawyers at 2.00 a.m. this morning to the effect that DSS BA would sign the letter withdrawing from the contracts we have with them, as drafted and agreed with ICL last Friday, in the knowledge of what had subsequently been agreed over the weekend. This undertaking was given on my authority, having consulted Vince Gaskell and Hamish Sandison on the draft agreement. The main developments over the weekend were in fact concerned with POCL funding, and issues between HMT/DTI and the POCL Board. The only direct issue of concern for us was the provision of an internal reassurance to the POCL Board about the timetable for moving to an ACT method of payment as the norm: I agreed with Steve Robson a form of words based on the reassurance Secretary of State had already offered in his letter supporting the deal sent late last Friday.
6. We will be looking over the final version of the ICL/POCL agreement first thing this morning.
7. I have been assuming that Peter Mathison will now wish to sign the documents of withdrawal. The signing procedure is arranged for 11.00 a.m. at Masons, the ICL solicitors.
8. **Announcement of the decision/setting off the DSS internal communication strategy:** DTI are in the lead on making the announcement and handling enquiries. At 3.00 a.m., perhaps not surprisingly, it had not yet been decided exactly when the announcement will take place. But DTI are aware of our view that the sooner we make an announcement the better, from an internal communication point of view; and they agree from their perspective also. As soon as I know the timing, I will let you know.

9. The announcement and briefing will be based on the drafts prepared by HMT on Friday to which we actively contributed. We have not seen the final versions from DTI; but I do not expect them to be substantively different. John Bretherton may wish to liase with his opposite numbers at Treasury and DTI to make sure that we are linked in at every level.
10. **First order questions:** I will be preparing a line for Secretary of State to take, following the DTI/HMT agreed announcement and briefing, as soon as we have the final version.
11. I will keep you in touch with further developments as they unfold.

MRS SARAH V GRAHAM
PFD Special Projects