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MAJOR PROJECTS EXPENDITURE COMMITTEE

03 MAY 1996

MINUTES OF SPECIAL MEETING HELD ON 30 APRIL 1996
AT 148 OLD STREET, LONDON, EC1V 9HQ

Present:

Members of the Committee:	Mr R.Close	(Chairman)
	Mr J.Cope	
	Mr J.Roberts	
Project Sponsors:	Mr R.Dykes	(Minute 96/45)
	Mr S.Sweetman	(Minute 96/45)
	Mr R.Tabor	(Minute 96/45)
	Mr B.Peaple	(Minute 96/45)
	Mr P.Rich	(Minute 96/45)
	Mr T.Brown	(Minute 96/45)
	Mr A.Shepherd	(Minute 96/45)
Secretariat:	Mr I.Caplan	(Secretary)
	Ms L.Walton	(Minutes)
Apologies:	Dr D.Grieves	

MP(96)42
BA/POCL
AUTOMATION

MP96/45
In considering the paper which was presented by Mr Dykes, and supported by Mr Sweetman, Mr Tabor, Mr Peaple, Mr Rich, Mr Brown and Mr Shepherd, the Committee noted that:

(i) the submission sought authorisation to enter into an 8 year contract (up to 3 years to develop and implement, followed by a 5-year contract) with one of three shortlisted Service Providers (referred to as "Tom", "Dick" and "Harry" for confidentiality), for the provision of automation of all post offices, and a new card-based benefit encashment service, together with 'in principle' approval for NRR expenditure up to a maximum of £10.0m for the implementation of the programme;

(ii) this submission followed on from MaPEC approval in March 1995, MP95/20, for planning costs of £5.7m for POCL's share of a joint development study with BA, amended in February 1996, MP96/24, to include a development test centre, contained within the initial authority. Sunk costs of £5.4m had been incurred to end March 1996;

(iii) since circulation to MaPEC, the paper had been further reviewed at POCL's Project Expenditure Committee (CoMPEC), and based on the findings of the Evaluation Board with Benefits Agency, the CoMPEC conclusion was that the contract with "Dick" should be pursued, and MaPEC were requested to approve this decision;

(iv) the recommended bid was due to be reviewed by the BA/POCL Programme Steering Committee on 1st May, but at present agreement had not been reached with the Northern Ireland Department of Social Security. This was not considered a showstopper by Sponsors, and the associated benefits had not been encompassed within the cashflows. If not resolved in the interim, this would be raised within the presentation to the POB; R DYKES/ S SWEETMAN

(v) the overriding importance was to meet business requirements, satisfy service requirements and deliver a robust technological solution, which may not necessarily be the best financial case;

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future programme implementation costs, assessed at £10m (£10.4m in outturn costs) for Counters 50% share had already been built into it's budgets/business plan forecast;

(vii) overall programme control would remain under the Programme Director, Andrew Stott;

(viii) the business case assumed benefits of £77m in NPV terms over the project life, from greater contribution through increased volume, whilst maintaining current pricing. It was imperative that as a minimum, one third of the forecast level of new business benefit had to be achieved if the project was to return a broadly neutral financial return;

(ix) the base case, which included an assumption of some rollout of Automated Payment Terminal (APT) offices, was worse than the Business Plan, which had assumed some automation would take place. Account Managers had identified benefits with and without automation, which had underpinned the verification process undertaken by Coopers and Lybrand, which supported a consistent approach to business assumptions. This review involved looking at the probabilities associated with each product and calibrating that against the extent of automation. The conclusion was that higher prices and volumes would be delivered with automation than without. The base case had not included new product areas. An 8% reduction in BA volumes would cause an overall zero NPV;

(x) the Transaction Information Processing project (TIP) was to be totally ringfenced from BA/POCL, with only small dependencies included in this submission. Back office savings were likely to deliver significant benefits and would be separately identified to TIP. Product development opportunities requiring both, were not included in this case. Sponsors confirmed that they were proceeding on the basis that any duplication of savings discovered would be taken out of TIP. Whilst TIP could itself be considered as a PFI candidate, this could be viewed separately from this case;

(xi) Sponsors considered that all POCL systems were interdependent, but were independently manageable, and assured the Committee that there would be no impact from other future cases that would cause this case to be altered. Sponsors confirmed that a quality assurance on the split between BA/POCL, TIP and the Distribution Systems project (DSP) benefits had been undertaken, and signed up to by the respective Sponsors;

(xii) BA/POCL was viewed as a strategic investment, automation itself provided a platform for POCL to exploit and therefore for prudence Sponsors had been cautious on the inclusion of benefits. This may place a considerable challenge on the retail network to deliver incremental benefits from the enabler of automation;

(xiii) the benefits from new product development and loss of automated dependent business had been excluded from the base case;

(xiv) the financial evaluation of risks had been incorporated within the worst case NPVs, however there were a number of risks outside of the financial evaluation, and these should be reported back to MaPEC;

(xv) since signing the Memorandum of Understanding in April 1995, BA had been targeted with a 25% cost reduction over the next 3 years, though this had not been incorporated within the base case analysis;

Sponsors advised that whilst they had evaluated a public sector procurement option for comparison of the financials and associated risks, it was not possible to answer the question as to whether there is a better option without PFI, as suppliers were not asked to quote on this basis, and therefore could have offered different solutions. Also the risks under public procurement would be different e.g. Risk transfer on fraud was 'closed' under Dick, but open and unlimited under public procurement;

(xvii) BA were not assessing a public sector procurement option for Automation; only a 'do nothing' option;

(xviii) the initial value factor evaluation/key performance indicators (KPIs), had shown that the 3 consortia had complied with the required programme selection criteria, with "Tom" and "Harry" indicating a higher level of compliance than "Dick". However as negotiations had progressed, that trend had reversed, and now only "Dick" was compliant;

(xix) the evaluation of suppliers had encompassed price/NPV, selection criteria and compliance. There had been a wide discrepancy in individual bids, in what had been offered during the tendering of bids and the final evaluation of tenders, which had meant, particularly for "Tom" and "Harry" inconsistencies, which now meant they were non-compliant, despite all 3 suppliers being similar on value factors (customer facing);

(xx) "Harry" was now the most expensive and least compliant, and had therefore been dismissed. It had presented a 7-year contract for steady state pricing, and was not the cheapest whole public sector solution. There was a high risk downstream in claims for costs. There had been a lack of clarity in the contract bid, the ability to deliver was questionable, and was very weak on remedies in the event of service failure;

(xxi) there was no significant differentiation on price for "Tom" and "Dick" for POCL or BA. "Toms" bid was considered as not PFI compliant as it would not accept card verification risk on fraud. To meet BA objectives therefore would result in a high cost to POCL through increasing its share of increased liability. Additionally "Tom" had restricted its costs e.g on the number of printers provided against requirements. Sponsors considered there were peak flow capacity constraints. In summary "Tom" offered limited recourse on liability, hidden costs and hidden risks. The criteria for opting for "Tom", given its technically more attractive solution, would therefore have been if it were able to be significantly cheaper;

(xxii) "Dick" was cheaper for BA/POCL, and was compliant in all areas but 2, which Sponsors considered not material. The supplier had provided clarity of response to all POCL requirements, and in particular had taken on board the requirement for onus of proof, which had not been acceptable to the other suppliers. The concerns related to the technical solution which had been addressed by Sponsors, and would be the subject of a report back to MaPEC prior to POB submission;

(xxiii) Sponsors concluded that "Dick" provided an overall best value for money solution, demonstrating a £10-15m NPV advantage when compared to the other bids, together with additional non financial benefits. Committee requested that the details should be provided to MaPEC, and would need to form the basis of a detailed benefits management plan; **R DYKES/ S SWEETMAN**

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(xxiv) POCL needed to confirm back to MaPEC that the final 'best' bid, after the financial evaluation exercise, cohered to previous discussions; **R DYKES/ S SWEETMAN**

(xxv) Committee were satisfied that due diligence had been displayed by the reviewing process employed, but expressed concerns on how this would be able to be monitored;

(xxvi) as a technical solution, "Dick" was the least preferred bidder providing a higher risk to delivering the programme. The evaluation team erred towards a 20-30% increased risk within a range of 20-50%, as compared to alternative technical solutions. This was offset by the fact that there were no payments until the system was delivered;

(xxvii) the preferred supplier "Dick" proposed a technical solution for which the architecture was unusual (complex design not proven on a large scale deployment using bespoke code which then had to be modified). Initially "Dick" did not have the technical or project management expertise within their project team, as compared to the other bidders who had proposed off-the-shelf solutions to be then modified. This had now been addressed by the computer supplier;

(xxviii) Committee <u>required</u> comfort that the technical solution proposed under Dick was acceptable to BA; **R DYKES/ S SWEETMAN**

(xxix) Committee stressed that accountability for delivery must rest with the supplier and not POCL, and that the supplier was to be made aware of these risks within the contract, and must demonstrate how they would handle these. Pressure would need to be maintained and hence there was a need to understand the technical side of what the supplier was doing;

(xxx) the risks associated with "Dick" were both short-term: liable to be late; pressure to accept incomplete functionality; premature roll-out could prove unreliable; and long-term: fragile software system; difficult to enhance; if Dick lost money it would be difficult to do future changes;

(xxxi) these risks were considered manageable and POCL would need to respond with:

- stronger technical assurance that this had previously been envisaged, resourced by POCL or outside contractors;
- development must not go in a direction counter to POCL requirements;
- rigorous user and system testing prior to roll-out to be built into the contract;
- evidence of a supplier contingency plan in the event of delays;
- careful review of supplier contingency plans as to how they would resource to resolve problems;

(xxxii) Committee considered that the additional risks associated with "Dick's" technical solution needed to be fully understood and documented, but that the risk was only relative, if it was capable of delivery without 'falling over';

(xxxiii) Counters must concentrate on the commercial output of the technical requirements ensuring that future flexibility was not reduced, and as such the key issue was to make the system work, as opposed to the technical platform on which it was delivered;

(xxxiv) Committee <u>requested</u> that appropriate conditions must be built into the contract, as the supplier would be under pressure to provide early delivery; **R DYKES/ S SWEETMAN**

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([redacted]v) Committee supported the selection of "Dick", subject to having the back-up material which demonstrated that all conditions had been met for the selection process;

(xxxvi) Committee's view was that the PFI solution was acceptable to all parties concerned. If BA and POCL were prepared to back it, and it provided an acceptable return to the Post Office, this was a sufficient condition. PFI was the only basis on which Government would allow BA to proceed, and as such the Post Office was not in a position to proceed with a public sector funding option;

<u>requested</u> that:

(xxxvii) in reviewing POB requirements to endorse MaPEC's recommendation, further information needed to be supplied to MaPEC as to supplier evaluation and the current status of the preferred bid, and the advantages/disadvantages of the three technical solutions; **R DYKES/ S SWEETMAN**

(xxxviii) the Board submission would need to address: **R DYKES/ S SWEETMAN**

- the base case approach;
- financials, risk assessment and verification process;
- analysis of supplier evaluation;
- the latest bid numbers;
- the criteria for the selected bid;
- the degree of compliance of the respective bidders;
- the positioning of PFI;
- the reasons for disregarding the other two bidders;
- the technology risks;
- the reasons for selecting the preferred bid, and with a higher risk technologically how these would be managed;
- risks (including fraud) - those associated with PFI, and those which are for POCL;
- POCL's ability to deliver it's commercial plans;
- the effects if the PFI went wrong and POCL's remedies;
- supplier credibility (credit worthiness/ownership structure and ability to deliver);
- the financial case for the Post Office;

<u>agreed</u> that:

(xxxix) there were a number of risks outside of the financial evaluation, and these should be reported back to MaPEC; **R DYKES/ S SWEETMAN**

(xl) the case was only marginally positive in NPV terms, and as such <u>requested</u> that if the finally negotiated contract was materially different (i.e. no better than the next best bid) to that presented, the financials should be re-presented to MaPEC for approval; **R DYKES/ S SWEETMAN**

(xli) further information, by way of updating the paper circulated, as to the choice of supplier, and the reasons for discarding the other bids, was to be provided to MaPEC to satisfy concerns over the evaluation process for the bids, to underwrite the recommendations put forward to MaPEC, and in support of the full submission to the POB; **R DYKES/ S SWEETMAN**

(xlii) the technical concurrence was unable to be definitive and final at this stage, and therefore there was a requirement to ensure that the proposed technical solution of the chosen supplier was signed off in a revised TCC prior to signing final contracts, as to the supplier working within the overall Post Office IS strategy (applications and architecture), and that POCL was not precluded from taking advantage of standard software upgrades in the future; **R DYKES/ S SWEETMAN**

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(xliii) once the contract had been agreed/awarded, the financials should be re-submitted to the Secretariat, encompassing full authority for the £10.4m programme implementation expenditure, with significant variances explained, for noting at MaPEC. This should then form the basis of future monitoring; and a six monthly report back to MaPEC thereafter. To avoid separate sets of information, a standard format of this report was to be used and should be agreed with the Secretariat; — R DYKES/ S SWEETMAN

(xliv) the individual assumptions detailed in both the base and PFI cases must be tracked and reported through a benefits management plan, and continued throughout the contract; — R DYKES/ S SWEETMAN

(xlv) Counters Executive Committee (CEC) should assume the role of Programme Board to oversee all future retail initiatives and the financial progress of the programme, reporting back on key milestones, timescales and financials, ensuring that benefits/costs are incrementally identified to the BA/POCL initiative; — R DYKES/ S SWEETMAN

(xlvi) the risk management plan must include provision for identification, and avoidance of, potential contract variations; — R DYKES/ S SWEETMAN

(xlvii) prior to Board submission, Financial, Operational and Commercial Concurrences should be forwarded to the Secretariat; — R DYKES/ S SWEETMAN

and, subject to the above conditions and Board approval, <u>authorised</u>:

(xlviii) POCL to proceed with the programme, if the evaluation of prices and risks of the revised bids shows that:

- the case had a positive net present value;
- the risk to POCL continued to be at an acceptable level;

(xlix) approval in principle of up to £10.4m in outturn costs, for POCL's 50% share of the remaining programme implementation costs.

MP(96)43 FEATHERSTONE STREET, RM

MP96/46

In considering the paper, the Committee <u>noted</u> that:

(i) the submission presented a single option of a replacement lease on 47-51 Featherstone Street, providing an NPV benefit over the full life of the remaining 20-year lease period of £1.068m, and a Sum to Determine Authority Level of £8.4m representing the EFL credit (notional disposal value). Additionally, the new commercial terms, provided the flexibility of a walk away option at 15 years. Due to the urgency of having to conclude terms with the landlord by 2 May, authority was requested in advance of the May MaPEC;

(ii) the new lease would result in the current annual rent for the property being reduced from £562k to £375k;

(iii) the option to reschedule the timing of the resulting £8.4m EFL credit was not available;

<u>agreed</u> that:

(iv) given the requirement under the new lease terms to return the building to its existing state, any proposed future refurbishment should avoid any suggestion that may significantly increase the costs to the 'return state'; — G COLLINGS

and <u>authorised</u>:

(v) surrender of the existing lease on Featherstone Street, and acceptance of the proposed new lease, incurring professional fees up to £20k.