

WITHOUT PREJUDICE

Rt Hon Stephen Byers
Chief Secretary
H.M. Treasury
Parliament Street
London SW1

9 December 1998

Chief Secretary,

Your letter of 20 November set a challenging deadline for ICL and the public sector to arrive at Heads of Agreement. Furthermore, you declared that you were looking for ICL to make a "speedy and decisive move". Because I share your impatience to find a speedy resolution to the outstanding issues, I initiated another round of contacts with the public sector.



Although we have had some further discussions with the public sector, there have been no definitive negotiations given the prohibition imposed by Ministers. This has made it impossible to reach Heads of Agreement. However, in the interests of resolving the impasse I am prepared to make a "speedy and decisive move".

A major criticism of ICL's proposals of 9 November 1998 appears to have been that ICL sought (in particular through the contents of its paper on Funding) to transfer risks back to the public sector. The impression was also created that Fujitsu was in the process of withdrawing its support from the Pathway project. There was also a view that the ICL proposals in the Commercial and Contractual paper represented unacceptable price increases. Our revised offer addresses all these points.

The contents of this letter have been discussed with Fujitsu and the Chairman of the ICL plc Board. Both support my proposal, but I must stress that it should be regarded as ICL's best possible offer. I have no hope of persuading my shareholder or my Board to give me further room to move.

First, ICL, with the support of Fujitsu, is prepared to fund the whole project. This represents an investment of £600m.

In addition, we have revised and restructured our commercial proposals. The table below summarises the effect of our revised offer on the public sector payments.

NPV (£M)	Corbett	ICL Proposal
BA	295	299
BES/OBCS	161	182
Other POCL	431	507
Total POCL	592	689

Keith Todd
Chief Executive

T K Todd
ICL plc
26 Finsbury Square
London EC2A 1DS
Tel: **GRO**

Direct: **GRO**
Fax +: **GRO**
e-mail: keith.todd@**GRO**

ICL PLC
Registered in England no 142200
Registered Office
26 Finsbury Square
London EC2A 1DS

NB

- The payments shown on this table exclude the effect of making payments quarterly in advance as the difference in timing occurs within the financial year of the public sector parties.
- BES/OBCS are provided by ICL under its contracts with POCL, but are services for the BA, which are recharged by POCL to BA under a separate agreement.
- The Benefits Agency payment of £299m is substantially below the £406m expected to be paid under the Original Contract. The BES/OBCS payment is broadly equivalent.



ICL is also prepared to accept an even higher degree of risk. Under the revised offer, ICL's NPV loss has increased to £118m and this figure does not include the additional risk taken on by ICL as a result of removing the contingency fund (see below). The table below summarises the impact of the revised offer on ICL. It shows that ICL's loss will be £269m (excluding the additional risk) on an investment of £600m.

(£M)	Corbett	ICL Proposal
NPV Loss	-224	-118
P&L	(555)	(269)
Total funding requirement	600	600

The other main features of our offer are as follows:-

- The proposal on contingencies is withdrawn. The costs of the programme based on the agreed project plan are included in the offer with no additional contingency. This has resulted in a substantial increase in cost and risk to ICL.
- ICL is prepared to forego the majority of the price increases sought in its offer of 9th November, in return for the removal of any discount on volumes. This increases ICL's risk substantially, since the system will have to deliver high volumes (well above guaranteed levels) before ICL will receive any material benefit from the removal of volume discounts.
- We confirm that we will accept all fraud risk as envisaged in the original contract.

We have submitted to your officials the full details of this offer including cashflows.

This offer represents an enormous commitment for ICL and one that can only be justified if we have confidence in the contractual arrangements, and the commitment of Ministers, moving forward. As I have said previously we have had limited opportunity to discuss the commercial and contractual issues with the public sector.

We have given your officials papers explaining ICL's revised proposals for Funding and Acceptance. The key points for Ministers are the following:

1. **Funding Paper**

Although Fujitsu are now providing the funding, there are still two important issues to address to support the major investment being made in the project.

This first issue is in relation to compensation for termination on Pathway default, force majeure and corrupt gifts. We are awaiting a response from the public sector on force majeure and corrupt gifts.

In relation to termination on Pathway default the public sector wish to retain an option to take over the Pathway system. However, ICL considers that, even in the event of Pathway's default, where the system has value, the public sector should be obliged to take over the system and make a value based payment (less, of course, any allowable set-offs as previously agreed) in return for the use of the system.

The second issue is that the Related Agreements should be clarified to ensure that Pathway should be compensated (through the existing Change Control Procedure provided for in the Related Agreements) for any increased costs or lost revenue arising from changes or slippage to the programme or changes to the system for which the Authorities are responsible.

2. **Acceptance**

Following detailed discussions, progress has been made on Acceptance. The parties have agreed that Acceptance will be completed prior to the start of National Roll-Out and is not linked to NR2+.

ICL considers that the relevant guarantees on volumes of transactions should be triggered at the start of National Roll-Out. This has been accepted by POCL, for its part, but not by BA.

There is agreement that an Independent Expert will be appointed to assist in the rapid resolution of acceptance disputes.

An issue remains about the exact powers of the Expert. ICL considers that the Expert should be empowered to make decisions which are binding on the parties, and should be implemented at once to avoid programme delay. Any party who did not wish to accept the decision should be able to reopen it subsequently through resort to arbitration, legal proceedings or subsequent agreement. This is already common practice in traditional complex infrastructure projects – such as major transport infrastructure projects – but it would also be appropriate for this project, given its complexity.

So far as the identity of the Expert is concerned, ICL recommends that Peter Copping of PA Consulting Group is appointed as Expert, because of his existing involvement with and knowledge of the project. If this proves



unacceptable then an expert from outside the UK (to ensure impartiality) should be selected by mutual agreement of ICL and the Authorities

Finally, an issue remains in relation to the number of allowable incidents at Acceptance. ICL asks that this is resolvable through a technical working group, but considers that the Expert, acting with the persons described above, resolve any disputes.

As you can see, I have made the "speedy and decisive move". I have done so to demonstrate ICL's (and Fujitsu's) total commitment to this project.



The Horizon project is tecnologically viable and politically desirable. Coupled with the heads of agreement for a public/private partnership signed with the Post Office, which the Post Office assure me they are anxious to pursue vigorously, I believe that the project will deliver for POCL the new future promised by its increased commercial freedoms just announced in Parliament. It is in the interests of all parties to move swiftly and decisively as has already been done by ICL. I hope that Ministers will now feel able to authorise the public sector to finalise the details around this proposal, so that definitive agreements can be quickly executed and the project can proceed to a satisfactory conclusion.

I look forward to hearing from you.

Yours faithfully,

GRO

KEITH TODD