HMT00000028

CONFIDENTIAL

FROM : STEVE ROBSON
DATE : 20 May 1999
EXTN : 4399
ROOM: 113/G

CHIEF SECRETARY

cc : Chancellor
Sir Andrew Turnbull
John Gieve
Harry Bush
Adam Sharples
Peter Schofield
Alan Mawdsley
Sarah Mullen
Ed Balls
Shriti Vadera
PS/SoS DSS
PS/SoS DTI
PS/Lord Falconer

POCL/BA

Issue: terms of a settlement with ICL based on B3

Recommendation: agree

Timing: immediate

Background:

2. Jeremy Heywood's letter of 11 May set out the Prime Minister's view that "any solution should meet three key political requirements". These were :

HMT00000028

i. we did not want a huge political row, with the Post Office or the Sub-Postmasters' lobby claiming that the entire rural network had been put in danger by the Government;

ii. we should not put ICL's whole future at risk; and

iii. it would be important to ensure that the Government had a fully defensible position vis-a-vis the PAC.

3. Against this background, we have been seeking a deal with ICL based on option B3. This involves abandoning the benefit payment card (BPC). POCL would buy the basic ICL Horizon platform. BA would move to ACT over the period 2003-05. This option could provide a platform on which to build POCL's network banking strategy and for Modern Government services.

4. On May 18 you met Alistair Darling, Stephen Byers and Charlie Falconer. Three main problems were identified with the terms then on offer from ICL. These related to :

- issues surrounding ownership of assets and IPR of the kit acquired by POCL;
- retention of payments by POCL until the Horizon system was performing satisfactorily;
- ICL demand for an immediate unconditional agreement.

There was also a large gap on price. ICL had made an offer which was estimated to give the public sector an NPV of £430 million. We estimated

HMT00000028

that termination offered us a better NPV of £543 million. (POCL's figures within this total continue to be a bit unstable.)

Ministers decided that I should make ICL an offer with an NPV for the public sector of £553 million i.e. £10 million better for us than termination. This offer was on the condition that ICL met our requirements on the terms set out above.

ICL rejected this proposal. Ministers met ICL on 19 May. ICL were in effect told that HMG was on a course to termination (the legal complexities of that course were such that this had to be expressed in careful terms). Ministers made clear they were willing to listen to anything more ICL might offer.

5. Following this meeting Lord Falconer met with HMG lawyers. In the light of this meeting I made a proposal to ICL on the issue of conditionality. ICL have responded positively.

6. The position we have now reached is as follows :

a. ICL have made a significant move on ownership of assets although POCL would like some more;

b. ICL have accepted our proposals on retentions;

c. ICL have accepted the price in our offer in paragraph 4 above;

d. an agreement will be signed now which will be unconditional but which will provide a specified period (about 3 months) during which POCL and ICL will negotiate detailed contracts. These would include agreement waivers by HMG and ICL for all claims arising from the Horizon project. If by the end of this

HMT00000028

period the parties cannot agree contract terms, POCL has the right to terminate;

e. if POCL did terminate, they would pay £150 million to ICL in full and final settlement of all disputes with ICL on Horizon. I attach a minute from the Treasury Solicitor. In his opinion this would be a good settlement for the public sector. It is the same as the figure assumed in our modelling of termination.

f. an aspiration, but not a commitment, that POCL and ICL work together to try and create a PPP to exploit the Horizon platform to deliver modern Government Services and network banking.

7. I consider this position would meet much of the Prime Minister's requirement. ICL believe they would have to take a provision of some size but they are not suggesting that their whole future is at risk.

8. We are in a reasonable position with the PAC. The deal gives us a little better NPV than termination based on a move to ACT in 2003-05 (we should not read too much into the precise figures which are as always somewhat soft). Ministers have previously decided that, as a matter of policy, they would not wish to make an earlier move to ACT following termination. As already mentioned, the Treasury Solicitor has endorsed the termination payment which would be made if this deal cannot be translated into satisfactory legal contracts.

9. As regards the Post Office and Sub-Postmasters, I cannot claim the Post Office are happy with this deal. Their chairman's views were set out in his letter of 18 May (attached). They really want option A - the benefit payment card. If the proposed deal goes ahead, the chairman set out certain terms including a <u>delay</u> in the start of ACT until 2005. This would

HMT00000028

have a seriously adverse impact (some £200-250 million) on the NPV of the deal.

10. He also wants guarantees on income from, and funding by, the Government and a firm commitment by the Government to use the POCL system "extensively for existing and new services". It is hard to see how these can be given. The Government will presumably want to use the best value suppliers for its services and not tie itself to POCL regardless of cost.

11. The sub-postmasters will no doubt be unhappy with the loss of the BPC and the timing of the move to ACT. But we would be providing them with an IT system which will automate their basic services, and provide a platform for Modern Government and Network banking.

12. We are working to finalise the terms and conditions in the legal document. Assuming this produces no surprises, I recommend that POCL should do this deal. There would be a parallel letter between ICL and DSS ending DSS's involvement in Horizon. ICL want to sign by 7am tomorrow, 21 May.

STEVE ROBSON