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Prime Minister

From: Geoff Mulgan  
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cc Lord Falconer  
Jonathan Powell  
David Miliband  
Jeremy Heywood  
Geoffrey Norris  
Sharon White

**Horizon, ICL and the Post Office**

1. A decision now needs to be taken on whether to proceed with the Horizon project. You will recall this is the initiative to automate the Post Office network, involving ICL. The project is nearly three years behind schedule, having been plagued with problems. Negotiations have been underway since the summer to find a way to continue the project.
2. The sums involved are big. Total spending, through DSS contracts, will be around £5bn between now and 2008.
3. After a tough period of negotiation ICL has made an offer which represents a significant move. Acceptance would still cost the government around £200m more than previously envisaged; equally, ICL would be set to lose £270m in total on the project. Their offer still leaves a significant gap with the government: £110m on funding, as well as differences over the practicalities of implementation. But the Post Office would be prepared to meet the funding gap out of existing resources, and, despite the continued opposition of the Benefits Agency, it will almost certainly now be possible to reach a settlement.

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4. However, the decision is not clear cut. The problems that have beset this project may well continue; continuation would lock the government in for 10-12 years to what many see as a flawed system; cancellation on the other hand would enable the Post Office to take advantage of newer, cheaper and more flexible technology, while the DSS could move rapidly to paying benefits into people's bank accounts. Cancellation would also release around £2-3bn over the next decade to be spent in other ways to support and automate the Post Office.
5. The attached paper sets out the main options and contains two alternative recommendations. Both options involve broadly similar financial implications for government.
6. In making a judgement, the following issues are paramount:
  - **The virtues of the project itself:** overall, Horizon, now looks increasingly flawed. It is centred around a technology, the Benefit Payment Card (BPC), that is both overengineered – and very expensive - and likely soon to be obsolete. Indeed, ICL acknowledge that the BPC will have no commercial value to them at the end of the project. Although they remain underdeveloped, the alternatives, which involve simpler off-the-shelf banking technology, look increasingly attractive, offering a route to universal banking, automated Post Offices and better provision of government information.
  - **The effects on the Post Office network:** cancellation would undoubtedly be destabilising. Subpostmasters fear that without Horizon they will lose their customer base. Their concerns can be partially, but not wholly, addressed

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through commitments on subsidy and promises that there will be government support for an alternative automation system. Rural subpostmasters' fears will be particularly acute. Subsidies could be structured to keep the great majority of these open, but, whatever happens, there will be a continuing stream of closures.

- **Effects on ICL:** Cancellation would directly affect 270 jobs in ICL and more in suppliers. It would destroy ICL's prospects of flotation and lead to a heavy (£200m) loss this year, although even if the project continues the £250m losses incurred so far may at some point have to be written off (*NB the figures in the attached paper are wrong on this issue*). Cancellation would also have a big effect on their reputation. It would probably force the resignation of the Chief Executive and would put them into a protracted legal battle with government, in which they would seek to pin blame on government in general and the DSS in particular. *[see letter from Fujitsu below]*
- **Effects on Fujitsu:** Fujitsu have provided the financial commitment to secure a deal. This is a sign of how important the project is for them. There would undoubtedly be a cost in terms of UK relationships with them in particular, and possibly with Japanese investors in general. They would argue that the government was guilty of a breach of faith: blaming ICL for what is in effect a change of policy.
- **Effects on PFI:** continuation would set a precedent for renegotiating PFIs that are failing; cancellation would make the funding of large IT projects harder in the future.

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- **Effects on the Benefits Agency and welfare reform:** continuation would hold up ACT. DSS estimate that they would save £800m if the project was cancelled. Government would also lose the opportunity to bank the unbanked.
7. Departments remain divided. Alastair Darling remains strongly opposed to continuing. Ian McCartney for DTI will argue strongly for accepting a deal (Peter Mandelson has largely kept out of the discussions). The Treasury is divided at official level, but Stephen Byers will probably, on balance, want to accept the deal for pragmatic reasons, even though he would prefer to cancel.
  8. At first glance, most of the factors point towards continuation. However my view, which Lord Falconer broadly shares, is that although short-term considerations and expedience point strongly towards making a deal, this will in the long-run prove unsatisfactory, leaving the Post Office and government dependent on a hugely expensive, inflexible, inappropriate and possibly unreliable system.
  9. In our view, the best outcome would be a deal with ICL to continue with an automation strategy which drops the Benefit Payment Card but focuses instead on helping the Post Office to provide banking services. This would enable a rapid move towards ACT and Post Office automation, but without the many problems associated with the BPC. It would also enable good relations to be maintained with ICL and Fujitsu. The costs to government and ICL resulting from the BPC could legitimately be blamed on the previous government.
  10. However, it will not be possible to reach this position without first rejecting ICL's offer and making it clear that the government no longer wishes to

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continue with Horizon in its present form. There would then be a danger that ICL would refuse to negotiate over a deal which excluded the BPC. In other words, this option is only feasible if the government is prepared to accept the significant risk that it would in practice lead to complete cancellation.

11. Our view is that the case for cancellation is, just, strong enough to warrant that risk, although it would need to be announced alongside a strong package of support for Post Offices and for an alternative automation strategy.

12. Ministers are meeting on Monday afternoon. There are essentially three options:

- Option 1: Attempt to conclude a deal, broadly along the lines offered by ICL
- Option 2: Seek a deal with ICL but excluding the Benefit Payment Card (recognising that in practice this may quickly lead to option 3)
- Option 3: Reject ICL's offer, move to terminate the project and press forward with an alternative.

13. Do you wish to give a steer?

*I would favour option 1  
but for Tom's statement  
that the system itself is planned.  
Surely there must be a clear view  
on this. Speak to me on Mon.  
ie. re: the enclosed  
papers, it all focuses  
ATD*

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on the internal deal.  
But there the rocks are pretty  
even, probably coming down on  
the side of cartoning. The  
real heart of it is the system itself