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## **ICL PLC**

### **Notes on discussion on the Pathway project (outside of the ICL PLC Board and Committee meetings) 13<sup>th</sup> May 1999**

**TKT**

A draft letter from Alan Milburn was received 1.00am, 36 hours ago saying that despite the merits of B.1. the Government could not justify (continuing with) it as it was poor value for money. They would however like to go forward by buying (not under PFI) the infrastructure and put in place an operating contract. They propose to pay 50% of ICL's audited cash costs to complete the contract in 4 months.

Also there were merits in B.1. and they would like ICL to work (in parallel) with POCL on the network – banking – modernising for government in the future.

Stepping back on previous events, the previous deadline had passed without the Government taking a decision by 23<sup>rd</sup> April as promised. ICL had told Steve Robson we could not continue and he requested ICL to go on to 10<sup>th</sup> May, when a decision would be ready, with up to £8m costs to be paid to ICL as an act of good faith. ICL agreed to this.

No doubt the discussions were taking a considerable amount of Ministers time as well as public servants time, and the time and commitment of POCL, time of BA, DTI and the Treasury. This matter affected the relationship of all the departments with the Treasury. The final decision was necessary from the Prime Minister and he did not have one recommendation, ICL believed, but a range of options. Stephen Byers supported B.1.2. as did Lord Faulkener. The negatives were Alistair Darling of the DSS who wanted to go straight to ACT and the Treasury who had reverted to type and said they were looking for value for money. In the hours before the decision it was clear that the Post Office was not being aggressive with its own business plan possibly because it believed that the Government would come up with the extra money. However it was also clear that a number of Government Ministers including the DTI were concerned about the quality of Post Office management to carry out the plans in the business plan.

Regarding the draft letter - there is now, for the first time a clear statement that they want the infrastructure i.e. the Post Office network and the recommendation that HORIZON needs to continue. HMG therefore wants to buy the (whole) infrastructure that ICL Pathway is putting in.

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However the draft letter is unacceptable and we have said no to it. It is silent on the commercial terms. If we cannot get a financial deal this week or next week we will not get a deal that is acceptable. Any deal likely to be arrived at after this week/next week, when pressure is off, will give ICL a loss in future.

Yesterday, Wednesday, ICL met Byers and Robson during the afternoon having met Robson earlier in the day. Our initial approach had been cold and silent and listening. We tried to understand how the dynamic concerning how the Government was thinking, was working. Last night (Wednesday) we took a firm line and set in motion and series of activities (after talking with Fujitsu).

Mr Sekizawa and Mr Naruto would stay over. Steven Byers had been told this and not told that the Board meeting was today. Robson was asked to arrange meetings with Ministers Friday.

Robson was also reminded that the letter in draft from Alan Milburn was silent on the Payments Card (on Monday ICL will begin roll out of a further 100 Post Offices which will be card enabled shortly afterwards). If this is not to proceed it should stop now. However, we think the Government wants a "without prejudice" stop on the card. Keith said no to this.

On our view of the financial dynamic we were clear ICL would not take a large loss and be a scapegoat for the public criticism of the project, which results mainly from Government delays. Keith was taking a firm line on this. The Treasury view was that in future the Post Office would take the deal to buy the infrastructure etc and pay the redundant costs especially on the card. This gets back to the seat of the original problem under the Conservative Government when they said the DSS had to take the payment card not ACT. The DSS have consistently undermined the project since then because they did not want the payment card option.

ICL did not expect the present draft proposal from the Government to work with the Post Office paying the redundant costs because it would be uneconomic and an outcry would come from the Post Office. All concerned need to understand the value of the network the Post Office is to buy and the Government must arrange some other method of funding of the rest of the redundant cost. ICL to see Steve Robson again at 5 o'clock today, Thursday.

At the meeting last night Robson did not reject the possibility the Government will pay some of the redundant cost and did not say they would not pay all. ICL thinks the Prime Minister wants a national network for the Post Office and we won't have a better time than now

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to get money out of the Government for this and for the redundant cost. Keith believes this is not an unreasonable approach. We have been very much abused. We can achieve this but we must have very significant pressure on the Government.

The Government is aware of the Fujitsu position and they want Fujitsu as a large inward investor in the UK. We have advised that Mr Sekizawa and Mr Naruto will want an audience with the Prime Minister to confirm a way to proceed, not to negotiate.

On the legal front, we have for 3 or 4 weeks taken legal steps to put the customers on notice they are in breach of contract. We need a legal basis of stopping the contract should we choose. Rather than we stop work and we cause the breach.

On the press, so far we have chosen not to use the press and wide press coverage could be painful for the Government. Keith thought we would stay our hand on the press for the moment because we could not of course be sure of a good outcome.

There would be interest in taking up the ICL Pathway case amongst opposition politicians for example Select Committee heads. This also on hold for the time being.

The letter we have sent to Steve Robson needs an answer, a resolution. Richard Christou is drafting the letter we want to receive. This will be a short letter which could later have many schedules of details but would be a legally binding heads of agreement. We have pointed out our Friday night/Monday deadline that Fujitsu has given ICL regarding the Fujitsu Group accounts figures.

All efforts Richard and Fujitsu were putting in would lead to a meeting between 12 and 3pm tomorrow Friday, to put pressure on closing the arguments in the next 24 hours. We have to have ready a contingency plan if that does not happen.

If the result was not satisfactory, the first escalation would be on Monday morning when we would stop work on the magnetic card part of the project. We could take the view that money of the taxpayers and ICL Pathway were being wasted. In parallel we were considering a press release and public statement.

**Mr Naruto:** Emphasised cost of continuing work including the cost of the card.

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- TKT** The total financial costs so far of the Pathway project have been £300m and then there would be shut down costs above this. He believed the redundant costs would be £180m including the cost to stop the magnetic stripe card – this was higher than the original £80m – this was real cost not revenue foregone.
- S Gillibrand** So the Milburn letter cost implication was £180m – unnecessary costs and the Post Office would acquire the system plus take out a service contract?
- V Davignon** The financial aspects would be supported by the accounts of ICL and Pathway in understated fashion – i.e. they could be audited and reviewed to back up the costs incurred. We needed to establish complete and full costs but costs which would not be argued with.
- TKT** Total costs to finish the project including redundant costs would be around £700m. Ongoing service support would rise over time peaking at £80m per year.

A policy decision was needed on what to charge; the submission to the Post Office and Government would be on the basis of 15% profit on design/development no profit on redundant costs and 10% profit on operating systems. This was the basis of the compensation claim. Richard would say this would be a tough negotiation. Although Steve Robson had been friendly to ICL we would have to fight hard and ensure ICL did not take a loss. Richard might say the bottom line would be to get out at cost with future opportunities leading to profit and this could be sufficient. But Keith thinks we could get out of this with profit because the Government wants the Post Office network and needs (SG) to put forward “the image of good Government”. Byers does understand ICL is to be floated and the Government wants this to happen. A loss on Pathway will not help and they know this but our job will be tough to come out with a profit. We have to be prepared they will play tough.

Keith’s position was now that on Monday we would ask for a termination payment on the card and continue on the roll-out if terms could be agreed. We would privately say to the Government we were prepared to stop if not resolved by next Friday. The Fujitsu accounts will go public on the 26<sup>th</sup> and we should prepare a public statement to make at the time of the Fujitsu results. Keith thought we could allow the Government between Monday and Friday to get things in place and that there would be a press conference on Friday with Byers and John Roberts and Keith confirming, if all went well before Friday that we have stopped the card and would continue with the network as in the draft Milburn letter. Alternatively if we did not resolve matters with the Government there could be a briefing from ICL that

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we have stopped work on the Payment Card and are looking for compensation (and might be prepared to go on with the rest of the network if terms could still be agreed).

**S Gillibrand** Does our legal position fit logically with stopping the card and going on with the network, is it not inconsistent?

**V Davignon** The longer we go on, on the basis that we think we can negotiate continuing with the network and only stop the card might weaken our legal case. We are simply reacting not following up our legal case.

**TKT** We will not take this proposed course if it will weaken our legal position.

There has to be a decision from the company not just a reaction. We have to be careful because of cost and effect on our employees.

**Mr Naruto** We should ask the Government do they want a magnetic card system, ask them specifically and their responsibility would be to answer and if they said no we could stop.

**Sir Michael Butler** As Keith said next week seemed to be crucial to either settle or break the relationship – there is always such an optimum moment.

The Government put us in a difficult position and made us live a lie. They decided in January they did not want to use the magnetic stripe payments card. Probably we could subpoena the Minutes of meetings which cover this. They did not come clean about this because if they had they would have to pay all the redundant costs. John Bennett's team had been working successfully for 4 months on a programme which they had already decided they did not need at a cost of around £50m for the taxpayer.

He thought it logical to stop work on the part relating to the payments card on Monday if we have to. This would be best. The letter we should draft for the Government to send to us should include cancelling the payments card and they could not deny this. But the legal and tactical situation on Monday would mean we could be quite strong. The last thing they would want would be Keith and Michael Butler to explain to the newspapers what had been going on in the last six months. We could produce an impressive chronology of devious behaviour by the Benefits Agency. We can explain the facts and why we are stopping work if we went to a total cancellation. We can win the propaganda battle and the legal battle. We can put effective pressure on the Government over the next few days. We should put the Government under heavy pressure to reach a settlement – that they will accept – otherwise they are wasting £300m of Government money. Keith's plan is best in present circumstances.

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**Sir Peter**

1. Approach of talking to the Prime Minister and officials being arranged by Keith and Mr Sekizawa – we have to do this.
2. We have to continue to work on the legal options.
3. Regarding press and politicians he does not feel we should go to politicians. The press environment is difficult. The background is, they believe that all big IT projects are difficult and late etc. Their and the public view is quite likely to be that ICL had wasted its money and the project was late so it was our own fault. Like the CAA project, 2½ years late. The natural inclination is that the supplier got it late. So press pressure can go in either direction. He thought the articles in the press so far on the possible cancellation had been reasonably balanced and had shown the project was although late, being successful. It was not clear who was leaking. We had to be very careful about putting pressure on the Government at this point in time.

There were two points to resolve:

1. What Fujitsu will say publicly in its accounts but Fujitsu can decide this in its time scale.
2. Whether to go ahead with the network and stop the card now as Keith was suggesting OR stop now in total and sue them. None of the discussions with Government so far had really produced anything so why could we conclude a successful deal by continuing with the network?

**TKT**

Steve Robson had given indications of the Government's good faith on this and said ministers had been up to 12.30 am to try and find a way forward. Now at last five ministers were aligned on the project outline as in the draft Milburn letter (but they were not necessarily aligned on how to pay for it). The advantage of the proposal would be to cut the Post Office and DSS apart and hopefully get out of the cash issue. It would lower the risk for ICL, be more realistic and we could look at future possibilities later. Keith said we have faith that we can fix the project if the Government go ahead, i.e. we have time. We cannot go to a flotation next year without the situation being clear.

**Mr Sekizawa**

As I explained the timing to Keith, Fujitsu's perspective is the announcement on 26<sup>th</sup> May but for Fujitsu internally next Monday is the date for the figures and when Fujitsu directors will gather to decide the figures which will be announced. By that time if the Government has not signed up and ICL make a big loss there will be a big effect in the Fujitsu accounts.

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26<sup>th</sup> May after the press conference there will be economists and analysts listening and we need to work out what to say to them when they question why there is such a big ICL deficit coming through in the Fujitsu accounts. We need to understand how much Fujitsu can talk frankly. This is a point we would have to put to the Prime Minister if we can see him. However if the details that Fujitsu can put in its announcement is not a strong blow to Government, there is no point in me meeting the Prime Minister. But if it is leverage I will meet him. So we need to come up with a draft of what I should say.

**V Davignon**

Has the same feeling as PLB on the press. It will emerge piecemeal. He is reluctant. At best the press will be even-handed, they will blame everyone and take the view that virtue is with them.

He referred to the issue of what we and Fujitsu say on 26<sup>th</sup> May. If we say that we are not happy but discussions continue we can lose leverage and damage our credibility for the future. So if before 26<sup>th</sup> May the Government has not come up with something acceptable to us then we need to say to the Government that we had confidence in them, we showed trust in them which was not reciprocated for 9 months. We trusted your modernising Government agenda. You have let us down.

But today/tomorrow we should say to them we hope our trust is not misplaced.

We seem to have had a good legal case for a long time now and have no choice but to consider breach of contract etc on the 25<sup>th</sup> and possibly earlier. Depending on how things go we must raise it with the Government.

We must say this matter will have influence on the flotation of ICL. If this causes problems on flotation it will be the Government's responsibility. We should say this to them earlier so they will not get a surprise on the 25<sup>th</sup>.

If a settlement is going to be found, they must make a proposal to us they must not ask us to give them another suggestion. They must take the responsibility for suppressing the card and thus have to meet the cost of cancelling.

We must say to the Government they have to pay what the Post Office cannot justify paying. The Post Office must pay what makes sense to them as an investment.

He sees difficulty with the situation we will have on Monday (if we are offering to go on with the network and stop only the card). He believes we have now got to the situation that all cards should be

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on the table and the bottom line position has to be given to the Government – if not we are in a very difficult situation.

**TKT** This is all helpful – we need to be mindful of the Fujitsu accounts deadline we may have between Monday and Friday to arrive at a solution.

**V Davignon** Advised that we could not go to the Government on Friday wanting an answer by Monday, next Friday would be a much better proposition. An approach asking for an answer on Monday would immediately put the Government on the defensive.

**TKT** There seemed to be two options:

1. To be prepared to stop now, this has two sub conditions:
  - a) to try to get what we want
  - b) to be prepared to stop and fight in the Courts
2. We need to decide with the auditors whether to take a provision in the ICL accounts and carry on negotiating.

We need to bring this to a quick conclusion even if it means we have to fight.

**Sir Peter** It looks like we will need a provision and have to consider this carefully. Regarding stopping the project, his gut feel was that we stop in total not a half stop with the network piece continuing and the magnetic stripe card terminating. We need to follow up the legal option or the Government must give us something which is a basis for going forward. We need definite figures for the ICL accounts and there is not enough time to do this, to meet the Fujitsu accounts timetable.

**Mr Naruto** A good aspect of this is that this is the end of the PFI this was the good part of the Milburn letter. Regarding the future with POCL, we should stop for the time being and prepare the price and set a deadline then be prepared to work jointly with POCL in the future.

**S Gillibrand to MB** Are we quite sure of the strength of our case? Did the Prime Minister know the strength of our case when he saw Mr Naruto and ICL previously. Sir Michael replied that when the Treasury panel reported there was no serious criticism of the system and a lot of journalists etc had seen it and were happy with it. Also John Bennett's team had been sticking to its recent plans successfully despite the Benefits Agency attempts to obstruct. So far we have not spoken to the press, so far we have not explained our side of the situation. It may be that Ministers have not been advised fully on the



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strength of our case? The Benefits Agency lawyers will have been blaming ICL Pathway.

**S Gillibrand** Do we get anything out of getting the press to help us. We have to take the high ground with the press and be confident.

**TKT** The legal case strengthens by the day – for example their agreement to pay £8m. We have a long list of points. Robson has said the contract would be a nightmare to terminate – in his mind he sees it as a nightmare! We have lived through this internally for 3 years.

**Sir Peter** We need to take a view on the provision in the accounts.

**V Davignon** It is important we bring it to a head, we have a legal obligation to the shareholder.

**Sir Peter** We can declare it and take a provision – we cannot go on wasting our assets, we know what we have to do. He remains concerned with the press, we need to stay on the moral high ground, easier to defend in the press if it comes up and better not put a gun to the Government's head through the press.

**TKT** Richard is working on a letter now and we are arranging meetings for Mr Sekizawa and Mr Naruto but they are not set, hopefully, they will be on Friday between 12 and 3pm.

**V Davignon** Also important that we have a note of the points to be put at this meeting with hopefully the Prime Minister or with Byers so that people not at the meeting can see it.

**TKT** George Hall and Keith will draft and discuss this with Mr Sekizawa in the morning.

The question was raised of the cost difference between stopping the card now and at the end of next week. Then it seemed that working towards a Friday the 21<sup>st</sup> deadline was better. We have created a pressure point for next Friday and with Mr Sekizawa will be able to put this over.

**Mr Sekizawa** If the UK papers came out with the story before Fujitsu announces results in Japan e.g. through an ICL press release disclosing a complaint with the Government this will then of course hit the Japanese press immediately that ICL will have a big deficit in its accounts and Fujitsu will be in a position that, if it did not, then it should have, disclosed the risk in its announcement.

Secondly, although Fujitsu's time scale is a results announcement on the 26<sup>th</sup> internally the figures should be put together on Monday 17<sup>th</sup> there are procedures we need to follow. We must work with our

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auditors so we need the ICL figures quickly. However I will check if our deadline can be relaxed from the 17<sup>th</sup>. I will speak to Mr Todd and Mr Naruto about this. (Subsequently some extra time was confirmed – to close of play on 19<sup>th</sup> May).

- V Davignon** If we do not have a satisfactory agreement we have to decide what the provision will be. He took the view that many companies have litigation and if we are comfortable we will be paid then this should not necessarily mean a provision of any level. It is a matter of disclosure. It may be we therefore do not have to take a provision if we are confident we will get paid.
- Sir Peter** 17<sup>th</sup> May is a very short timescale, do we go to the Government to put a gun to their head and say how urgent it is for us. Do we explain we have the high ground and say over to you regarding our timescale. Regarding the figures, this is an important issue for Fujitsu and they have to assess it with their auditors. Then after Fujitsu and its auditors have done so ICL should decide what its provision should be (? is it a provision or no provision but just disclosure of uncertainty etc).
- TKT** PWC our auditors are not prepared to go with no provision.
- S Gillibrand** If it is going to the Court it may be we do not need a provision but Fujitsu need to consider their provision.
- V Davignon** His experience with auditors is to discuss the risk and explain it to them but based on the possibility of recovery it may not be necessary to take a provision.
- Sir Peter** Should we request the auditors sign up for 25<sup>th</sup> May then we go public. If we are forced to take a provision at around £200m this will be severe on ICL. Fujitsu can choose or not choose whether to make a provision and declare the risk for their announcement. For our accounts are we in a different position, do we have more time.
- TKT** We are in some ways de-coupled from Fujitsu but we need to check with their auditors, we could be included as a material subsidiary, (so their announcement may have to reflect exactly what we do).
- Mr Naruto** This is an ICL and Fujitsu matter not relevant to Government. We have to say something to the press but on litigation the Government may not be afraid - they can take a long time. Our only leverage is to abandon the infrastructure of this project and they have no hope for the future of POCL.
- Sir Peter** If the auditors sign off the provision we have to understand how this affects the bank exposures and our trading position. The Board are

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ready to terminate - we need at some stage to check the auditors position.

**TKT**

The auditors were happy with the B.1.2. situation they have not seen the latest scenario. The question arises what the auditors would do if we believed the situation could be recovered.

Keith described the banking situation and Fujitsu guarantee for £173m and the effect of a provision on ICL's balance sheet. Also the question arose of whether further Fujitsu support might be needed. At what point would a material change under the Facility Agreement have to be reported to the banks? We needed a contingency plan with the banks when we go public. A key trigger is the size of the provision, and the line the auditors will take.

**Mr Naruto**

Emphasised stopping the PFI project.

Mr Sekizawa, Mr Naruto and Keith would plan for the meetings tomorrow.

**Sir Peter**

Talked again and there was further discussion about the accounts and auditors. And there was discussion on how we got to £132m as a provision level for the Pathway Limited accounts. If there became certainty of legal action this would be helpful in regard to deciding what needed to be shown in the ICL accounts. Intermediate situations concerning provisions, uncertainty, qualifications etc were possible. Vicomte Davignon emphasised it was not exclusively an accounting debate but a fundamental issue, we might be deciding in a range between a clean bill of health and a qualified opinion. Mr Owen mentioned provisions were arrived at on the balance of probabilities.

TKT would work on the negative scenario in the event the matter was unresolved.

If we took a provision we did have to be careful. Generally we did not want to qualify the accounts. The necessary back up from Fujitsu had to be in place before we could sign off.

RFS  
14<sup>th</sup> May 1999