

MD4068

ICL file

WITHOUT PREJUDICE

Mr Stuart Sweetman
Managing Director
Post Office Counters Limited
King Edward Building
King Edward Street
London
EC1A 1AA



10 March 1998

Dear Stuart,

Following John Bennett's conversation with Paul Rich, I am enclosing a courtesy copy of the letter and position paper that I have sent to Peter Mathison.

Yours sincerely,

GRO

Keith Todd

Enc

Keith Todd
Chief Executive

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Stuart Sweetman

- MD POL

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6th March 1998

Mr. Peter Mathison,
Chief Executive,
Benefits Agency,
Quarry House,
Quarry Hill,
Leeds.
LS2 7UA



Dear

Peter

I refer to my letter to you of 2nd March, and now enclose on a without prejudice basis a position paper which sets out ICL's views in relation to the Pathway Project.

May I suggest that we arrange a further without prejudice meeting after you have considered the enclosed document so that we may continue to seek a way forward in this matter.

Yours sincerely,

GRO

Keith Todd

Keith Todd
Chief Executive

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WITHOUT PREJUDICE
5 MARCH 1998

Position Paper

PATHWAY

Introduction

The purpose of this summary is to inform BA/POCL (the Authorities) of Pathway's position in relation to the Pathway Project (the Project), in order to facilitate proper commercial discussions to resolve the present problems and differences facing the parties on the Project. The key issues have been summarised under headings, with the aim of providing an overview of the problems which Pathway has experienced in performing the Project in the context of a PFI contract.

PFI Principles

The foundation of a PFI contract rests upon clearly defined commercial principles which reflect the correlation between risk transfer and management of risk. The aim of PFI is to allocate risk to the party best able to manage it. The Supplier takes the entire risk of providing a solution to meet the business requirements of the Sponsor but, in turn, the Supplier is given the overall freedom to determine the solution to be provided. It is therefore fundamental that, having transferred the initial risk associated with the implementation phase of a project, the Supplier should not be hindered during this phase by the Sponsor. It is for the Supplier to manage the technical aspects of the project in an expeditious time frame so that the Supplier is capable of earning revenue which is commensurate with the risks of the project. The European public procurement regime which

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stipulates competitive tendering, and hence competitive pricing, for PFI contracts, fortifies this principle.

It follows from this overriding principle that the Sponsor has the right to monitor the contract work and the right to reject the IT solution following acceptance testing if the solution is unable to meet the acceptance criteria. However, the acceptance criteria can only be based on the Sponsor's business requirements. In other words, having defined the requirements to be met by the system, it is not then for the Sponsor to dictate the solution, which must remain the exclusive responsibility of the Supplier. It is also incumbent on the Sponsor to ensure that it carries out its responsibilities for technical interfaces or other Supplier related dependencies in an efficient manner so as not to delay the Supplier.

The problems which Pathway has faced and continues to face on the Project arise from the fact that, as shown below, the Authorities have breached these basic PFI principles. Moreover, BA has compounded the situation by separately misrepresenting the true position with regard to the availability of CAPS and the CAPS programme.

Design Interference/Enhanced Requirements

In hindsight, it is perhaps understandable that, owing to the nature of the Project, namely, the automated payment of billions of pounds worth of benefits, neither Authority was able to divest itself of the political risk of Pathway's solution proving inadequate. In the case of Pathway, the Authorities have not constrained themselves to expressing their requirements at a high level, leaving Pathway the freedom to implement them in the way Pathway thought best and most appropriate, having regard to the risk it faced in the implementation phase. Instead, the Authorities have gone much further, engaging in a continual process of refining their requirements to such a level of detail that Pathway has had no option but to carry out the Authorities' detailed instructions. In practical terms, they have interfered in the design process by wrongly taking over the role of the design authority.

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The result is a computer system which far exceeds in size and complexity the solution which had originally been envisaged as necessary to deliver the Authorities' business requirements. - Indeed, as a result of these enhancements to the solution as required by the Authorities, the system which now exists is a bespoke solution of huge complexity. These enhancements have inevitably created a ripple effect on the time and cost to build and operate the system and the overall work that Pathway has been obliged to undertake on the Project.

It is not uncommon for a Supplier in a fixed price contract to face the problem of users enhancing requirements under the guise of clarifying them. In a PFI contract this problem is all the more acute as the Supplier does not have the benefit of a fixed payment. The Supplier must then achieve live operation as soon as possible so as to enable a revenue stream to come on-line under the service provisions of the contract. The Supplier is thus driven to avoid protracted negotiations and make as little use as possible of any contractual protections that may involve conflict, in order to minimise delay. This is the situation which Pathway has suffered, severely aggravated by the Authorities' attitude that, as the Project is PFI, their requirements may be enhanced at Pathway's expense, as Pathway is obliged to fund the work.

The Authorities/PDA

The Related Agreements (the Contract) require Pathway to deal with the Authorities in a tripartite arrangement. Pathway understood that the Authorities would adopt a unified position on the Project. Instead, with the Authorities having separate business objectives and agendas, differences between the Authorities have emerged and have resulted in conflict which has been one of the primary causes of delay.

In the course of pre-contractual discussions it was represented that the PDA would be a competent management body, properly empowered to work with Pathway, so as to ensure an efficient and expeditious implementation of the solution.

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In the event and totally contrary to this representation, the PDA has sought to manage the Contract as a joint agent of the Authorities but has lacked the competence and proper authority to do so to the extent that no decision could be taken by the PDA without the direct agreement of both Authorities. This has caused delay, which has been compounded by the fact that a large part of the PDA's remit has been to broker agreement between the Authorities rather than exercising any powers of its own to provide approvals or otherwise to progress the Project.

The imposition of the PDA between Pathway and the Authorities has acted as a hindrance to the proper understanding of the Authorities' requirements in circumstances where direct access to the Authorities has been denied. The Contract did not contemplate that Pathway would be obliged to deal with the PDA in these circumstances. Indeed, the PDA is an extra-contractual body, whose role is in no way defined or mentioned in the Contract apart from a tangential reference to the role of the PDA Board in dispute escalation.

The contractual programme was based upon an aggressive implementation timetable, partly to achieve fast business returns for the parties and partly for political reasons. The short Steady State period of only five years fortified the premise that implementation would proceed without unwarranted delay. Regrettably, delay has been the hallmark of the Project inscribed by the PDA, which, without its own business case or incentive to expedite the Project, has acted as if there was no correlation between time and money.

At the pre-contract stage, had the true role of the PDA been accurately described, Pathway would have reconsidered the commercial terms upon which it entered into the Contract.

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A Drop Down phase of three months was prescribed in the Contract in order to clarify the Authorities' requirements as part of the process of extrapolation and transposition of the Authorities' requirements.

In reality, the Authorities used the Drop Down process as an opportunity to enhance the requirements (for the reasons previously mentioned) by presenting Pathway, through the PDA, with hundreds of redrafted requirements. The volume of work involved in this process meant that the Drop Down period had to be extended by a further three and a half months but even this further period was inadequate fully to identify the Authorities' requirements.

A major reason for this was the fact that the degree of business analysis that had been carried out by the Authorities prior to the Contract was insufficient to enable the design to be frozen.

By reference to the stated requirements and the aggressive Project timetable it was implicit that such work had been done, but this proved not to be the case.

In the absence of such analysis the Authorities were unable to explain high level requirements in terms of end to end business process definitions, business rules or outputs and, in order to avoid delay, Pathway was obliged to work as an unpaid consultant, carrying out business analysis for the Authorities, whilst performing parallel design work.

A number of the requirements were contradictory and misleading.

Pathway discovered that many business processes simply did not exist and this complicated the task. Pathway was unable to perform the analysis work in the usual way (by Pathway interviewing the Authorities' staff, observing business practices etc.), as Pathway did not have direct access to the Authorities. Instead, Pathway was obliged to deal with the PDA, which involved a cumbersome

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and time consuming process of submitting draft documents to the PDA for eventual comment by the PDA and the Authorities.

In the absence of defined business processes and direct access to the Authorities, the process also involved Pathway having to speculate on the Authorities' requirements, which, when formulated, the Authorities would consider and then optimise.

Towards the end of the extended Drop Down period it became clear that these efforts would not be sufficient to define the Authorities' detailed requirements. As a practical matter it was agreed that the parties would resolve outstanding requirements by using reasonable endeavours to agree Agreements to Agree.

This proposal was founded on the basis that any requirements which the parties managed to agree would be phased into the Project in a reasonable timeframe by way of change control. On this basis, Pathway agreed to the proposal. However, the Authorities have used the Agreements to Agree as a further means of imposing detailed processes and features not previously specified in the requirements which, once agreed, are required to be implemented in unreasonable time frames.

In light of the delay to the Project it was acknowledged by the Authorities that it was not feasible to deliver the programme to the original time-scales. Consequently, following Drop Down, the parties entered into discussions to establish a new programme plan. However, in the absence of a firm, detailed baseline, and in order to progress the Project, Pathway was forced to undertake work in anticipation of the Authorities' eventual requirements. As and when the requirements were crystallised substantial rework, without compensation, had to be carried out by Pathway in order to make the solution compliant with the contractual requirements causing further delay.

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PATHWAY****Change Control**

The Contract contemplated a specific change control procedure which involved the Authorities and not the PDA. Instead change control has primarily been dealt with by the PDA as an administrative task involving prolonged consultation with the Authorities. This has caused widespread delay to change control.

Against the background of the Authorities acknowledging that the original change control procedure lacked the required degree of expedition for the Project programme, and in order to overcome delay, Pathway progressed work on the Project in accordance with informal instructions from the PDA, pending formal approval of changes to the contractual baseline. This agreed approach of working in anticipation of formal change requirements took place in circumstances where substantial delay was being experienced in obtaining the Authorities' agreement to change control. It was intended that there should be some form of risk sharing by the parties in these circumstances, but, in reality, it is only Pathway that has suffered the consequences of operating change control in this way. Pathway worked in anticipation of formal change but, when the Authorities eventually agreed (through change control) the detail of their requirements, substantial time was spent by Pathway carrying out rework. Pathway has throughout been faced with uncertainty when implementing the solution in an attempt to meet a constantly moving contractual baseline. This problem has been exacerbated by the necessity for Pathway to carry out parallel analysis and design work which, with the overall delay by the Authorities in dealing with change control and the need for rework, has caused a totally dynamic situation. In these circumstances any attempt to assess the impact of an individual change would have been futile especially where some agreed changes were undefined and imprecise.

CARs

The Contract involves many dependencies by Pathway on the Authorities, which to a large extent were expressed in the solution as the Contracting Authorities Responsibilities (CARs). Many

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CARs relate to the definition of interfaces, processes, rules and other vital matters required by Pathway to complete the design and implement the solution. Pathway entered into the Contract on the basis that the essential design related CARs would be fulfilled by the end of the initial three month Drop Down period in order to meet the Project programme. It was implicit from the aggressive timetable that the Authorities would be able to meet their responsibilities in a timely way but this has not proved to be the case. Even today some of these essential CARs remain outstanding, and others are the subject of Change Requests. By way of example, there are approximately 35 outstanding CARs and 213 classed as ongoing, where there remains residual, periodic or further obligations on the Authorities. The significant delay by the Authorities in meeting CARs is related to the fact that the Authorities did not undertake a proper business analysis which would have enabled them timeously to discharge their responsibilities.

POCL

It became apparent during installation work for the first 200 Post Offices that many post offices are not fit for the purpose of installing automation equipment. POCL could not reasonably have believed that the Post Office premises were fit for automation and did not give Pathway a proper opportunity to investigate the physical condition of the POCL premises for itself before entering into the contract. If the extent of the work required to render POCL premises fit for installation of automation equipment had been made known at the pre-contract stage Pathway would have adjusted its bid price accordingly and allowed more time for this work in planning. Indeed, the full impact of this problem is still being assessed. Of greatest concern are the substantial additional costs and the possibility that the problem is so severe that it will not be possible to maintain the required "beat rate" during National roll out. Indeed it would appear to be impossible to automate all post offices in their current role.

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CAPS

Quite apart from the substantial issues mentioned above there is the serious problem concerning misrepresentation in relation to CAPS.

It was represented pre-contract that CAPS would be available in one single feed for integration testing on the 1st September 1996. The BA's Benefit Migration Plan was predicated on this basis and the rapid migration of benefits set out in the plan was of fundamental importance to Pathway in determining its pricing mechanism. This reliance was well known to the Authorities, but nevertheless the date given by the Authorities for the availability for CAPS and the consequent dates shown in respect of the Benefit Migration Plan have proved false (as shown by the attached schedules). It appears that no proper enquiry was made of the status of the CAPS programme before these representations were made. Indeed, it is now apparent that BA realised at the outset of the Project that the CAPS programme could not be delivered in accordance with the time scales set out in the Benefit Migration Plan. Given the earlier representations, Pathway should have been informed of the actual situation as soon as the real position was realised. This is all the more so, in light of Pathway's earlier concerns as to the availability of CAPS, in circumstances where Pathway was prohibited from having a direct dialogue with CAPS to confirm the true position.

CAPS is so fundamental to the viability of the Project programme that had Pathway known the true position it is doubtful whether Pathway would have entered into the Contract. At the very least Pathway would have priced the services to reflect the deferred CAPS programme and revenue loss. Following award of the Contract, if Pathway had been told of the delay to the CAPS programme, Pathway would have had the opportunity and time to mitigate the impact of such delay and respond commercially to the changing circumstances of the Project. Pathway would have been relieved of the coercive effect of the aggressive timetable, which drove Pathway to minimise delay and absorb additional cost without proper recourse to the procedures laid down in the Contract.

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Indeed, it now seems that the true position as to the CAPS programme was deliberately concealed from Pathway for several months. It was not until February 1997 that Pathway received notification of the delay to the CAPS programme, by which time fundamental principles relating to the basis of the replanning exercise had been established and these involved Pathway making further substantial commercial concessions so as to minimise delay to the Project.

It is now proposed by BA that a CAPS programme implementation pilot should be undertaken with an option to defer the benefit rollout. This proposed pilot demonstrates the underlying weakness of the CAPS programme and the extent to which CAPS readiness was misrepresented. Indeed, without a state of readiness on the CAPS programme BA has no incentive to progress the Project. On the contrary, it is clearly in the interests of BA to prolong the pre-acceptance phase of the Project so as to avoid payment of guaranteed sums.

Global Effect

In the context of a PFI contract, Pathway was entitled to proceed on the basis that there would be no intervention from the Authorities. Pathway should have been unfettered in its provision of a solution to meet the Authorities' requirements. Instead, Drop Down and Agreements to Agree have been used to enhance the requirements so that Pathway has been driven further and further away from its original solution.

The consequent delay and cost has been compounded by the lack of preparation on the part of the Authorities, in failing properly to carry out business analysis, which in turn has contributed to delay in crystallisation of the Authorities' requirements and discharge of CARs.

In the belief that Pathway had to minimise delay to earn revenue by striving to meet the CAPS programme, Pathway conceded many commercial and contractual issues. This has involved Pathway working, without compensation, in anticipation of formal approvals and requirements.

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Substantial time and delay have been faced by Pathway in respect of rework and abortive design work which has been carried out in parallel with Pathway's unpaid consultancy work, all of which have been aimed at expediting crystallisation of the requirements. The management structure of the PDA and its lack of authority has prevented Pathway from expeditiously dealing with the Authorities and has intensified the overall delay.

The global effect of all these issues is that Pathway is facing revenue loss and increased costs which run into hundreds of millions of pounds. As is well known to the Authorities, Pathway secured loan facilities of £200 million to fund the cost of performing the Contract. The additional work and delay, which have deprived Pathway of revenue, have caused Pathway to draw against the loan at a much faster rate, with the overall borrowing requirement having virtually doubled.

Yet, despite all the issues which Pathway has been obliged to contend with, Pathway has prevailed by achieving Release 1C. This release involves automated payment of child benefit being made at 205 Post Offices, across 335 counters.

In the next few weeks some 40,000 claimants will be using the payment card to collect Child Benefit. The service is well liked by the Post Office counter staff and benefit claimants and meets the requirements expected of it. Pathway is providing a world-class service management system and have a committed and structured approach to completing the Project.

Clearly, Release 1C has not come without its price, and the plain truth is that, despite all Pathway's efforts and achievements, Pathway will not be able to earn its rightful revenue because CAPS is not available.


The global effect of the issues raised in this paper is such that an increase of 30% to the pricing mechanism would be necessary in order properly to compensate Pathway. Pathway now seeks an appropriate commercial solution to compensate Pathway for the global loss it has suffered as a result of the Authorities' performance of the Contract and the misrepresentation as to CAPS.

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SCHEDULES

COMPARISON OF CONTRACTUAL VS. ACTUAL CAPS AND PATHWAY RELEASE DATES

		SEPT. '96	APRIL '97	MAY '97	JUNE '97	JULY '97	NOV. '97	FEB. '98	OCT. '98
ORIGINAL CAPS POSITION	CAPS releases & dates	1 Version Release containing full functionality							
	PATHWAY releases & dates	Initial Go-Live	Release 1 on 1 April			Release 2 on 1 July (3 months later)			
CURRENT CAPS POSITION (subject to pilot scheme currently under discussion)	CAPS releases & dates		Version 2.0 of CAPS multiple releases on 1 April		Version 2.1 of CAPS multiple releases on 2 June		Version 2.2 of CAPS multiple releases on 24 November	Version 3.0 of CAPS multiple releases	
	PATHWAY releases & dates	Release 1a		Release 1b on 4 May			Release 1c on 3 November (Live)		New Release 2 on 5 October



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BENEFIT MIGRATION PLAN - REVISED DATES

	ITT/Contract 8th Feb '96	Master Plan 11th Oct '96	CAPS Plan 16th Dec '96	Change Request	Delay in Months	Benefit Pop'n Millions
Start Dates						
Child Benefit	Sep - 96	Jan - 97	Apr - 97	Jul - 97	10	6
Incapacity Benefit, SDA, WB, MA	Nov - 96	May - 97	Sep - 98	Sep - 98	22	2
Family Credit, DWA, ETU	Apr - 97	Jul - 97	Apr - 98	Apr 98	12	1
DLA, AA, GA	Apr - 97	Sep - 97	May - 99	June - 99	26	2
Retirement Pension	May - 97	May - 97	Sep - 98	Sep - 98	16	8
Income Support	Oct - 97	Oct - 97	Jan - 98	Mar - 98	5	4
JSA	Oct - 97	Oct - 97	May - 98	Jun - 98	9	1
Social Fund	Jan - 98	Jan - 98	Jan - 99	Jan - 99	12	3
War Pensions	Jan - 98	Jan - 98	Jan - 00	May - 99	16	0
Clerical	Jan - 98	Jan - 98	Jan - 99	Jan - 99	12	1