

POST OFFICE BOARD: 20 July 1999

POB(99)47

**IMPLICATION ON THE POST OFFICE OF  
THE 24 MAY 1999 HORIZON AGREEMENT**

**Purpose:**

The Board must decide by 31 July 1999 if it can and wishes to terminate or sign the revised contract with ICL for the automation of post offices. The signing of the contract will commit Post Office Counters Ltd to significant financial undertakings. In addition, the Government has informed The Post Office that it intends to move all benefit recipients with bank accounts to ACT from 2003 to 2005. This paper outlines the impact and seeks Board approval to the signing of the contract with ICL.

**Strategic implications:**

The implications are:

- significant additional costs of the Horizon infrastructure;
- a fall in benefit payments business following the promotion of, or compulsion to, ACT;
- potential force majeure closures of between 2,000 and 7,000 offices impacting both POCL's nationwide network and RM and PFWW's universal service obligations;
- that continuation (with ACT) supports Network Bank aspirations;
- the lack of a benefit card, together with ACT, damages Government Gateway strategy, making it only marginally positive over 10 years;
- loss of footfall, reduction in office numbers and an increase in costs due to Horizon have a significant adverse impact on Royal Mail and PFWW.

**Costs/benefits:**

Scenario	No.	Impact on POCL NPV (£m)		Impact on PO NPV (£m)	
		5 Year	10 Year	5 Year	10 Year
Continue	1	-189	-161	-134	-115
Continue	2	-278	-487	-319	-672
Continue	3	-443	-674	-484	-859
Terminate	4	-1011	-1310	-1098	-1540
Terminate	5	-654	-1002	-777	-1336

Continuing with Horizon is least bad.

**Recommendations:**

The Board is asked to **agree** to:

- the signing of the revised contract with ICL;
  - interim project funding of £11.03m until a formal MaPEC in September; and
- to **agree** that work should continue on:
- stopping or delaying the move to ACT;
  - reducing the ongoing cost of Horizon;
  - reviewing channel strategy;
  - persuading Government to ring fence the Horizon costs; and
  - how the Government could subsidise the nation-wide network.

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**1. Background**

Heads of Agreement with ICL on the future of Horizon were signed on 24 May 1999. Detailed codification of these Heads into a contract are expected to have been completed by 16 July 1999 prior to the Board's consideration of its terms on 20 July 1999. The signing of the contract will commit Post Office Counters Ltd to significant financial undertakings. In addition the Government has informed The Post Office that it intends to move all benefit recipients with bank accounts to ACT between 2003 to 2005.

**2. Purpose of the paper**

This paper outlines the impact of the new contract and seeks Board approval to the signing of the contract with ICL.

Following extensive reviews by Government, BA withdrew from the Horizon project on 24 May 1999, ending its need for a benefit payment card. The Board agreed that POCL would continue with the project on new commercial terms subject to the agreed codification of the Heads of Agreement signed on 24 May 1999 (with an option that if codification was not agreed, POCL could terminate with the payment of £150m to ICL), and the use of £480m of gilts to fund payments to ICL. The codification process ended on 16 July 1999 without any material disagreement allowing termination.

The key elements of the new deal are:

- functionality consists of Electronic Point of Sale (EPOS), automated payments, local feeder systems and the Order Book Control System (OBCS: bar-coded order books);
- additional functionality, such as Network Banking and Government Gateway, will be possible at an extra cost of c£120m;
- the system will be rolled out by March 2001 (based on a roll out rate of 300 offices a week);
- the contract will terminate on 31 March 2005;
- payments will be made as follows:

- Capital sum of £480m to be paid, less a 25% retention, over the next two years (retention to be paid over subsequent four years);
- a payment of £68m to be made on acceptance;
- following roll-out, operating payments to be made of c£95m p.a.;
- operating costs are 61% fixed, 32% variable with number of outlets and 7% variable with volume;
- in addition POCL will have to bear the cost of unrecovered VAT;
- termination options available are:
  - system fails acceptance, and no payments to ICL;
  - for convenience, with payments in the order of £450m.

#### 4. Evaluation of impacts

In evaluating the new contract, the following scenarios were examined:

1. Horizon continues with increasing drift to ACT.
2. Horizon continues with heavy promotion of ACT.
3. Horizon continues with compulsory ACT from 2003 to 2005.
4. Horizon is terminated and an alternative automation is introduced, with compulsory ACT.
5. Horizon is terminated and no alternative automation is introduced, with compulsory ACT.

All scenarios have a negative NPV. The least bad scenario, Horizon and ACT drift, has significant negative cash flows and losses over the next four years. In all other scenarios the cash flows are negative and POCL incurs losses for the next ten years.

The consequential impacts on Royal Mail and Parcelforce Worldwide, and the loss of interest on the £480m of investment, further worsens the Group position. Some benefit may be available from tax relief from capital allowances.

A summary of the cash flow and profit and loss position is at Annex A. In NPV terms the relative positions are as follows:

Scenario	Impact on POCL £m				Impact on PO £m			
	5 Year		10 Year		5 Year		10 Year	
	NPV	Ave. profit	NPV	ave. profit (2nd 5 years)	NPV	Ave. profit	NPV	ave. profit (2nd 5 years)
Bus. Plan	43	54	226	166	n/a	n/a	n/a	n/a
1	-189	-82	-161	65	-134	-72	-115	60
2	-278	-108	-487	-47	-319	-122	-672	-117
3	-443	-150	-674	-58	-484	-164	-859	-128
4	-1011	-166	-1310	-91	-1098	-187	-1540	-161
5	-654	-94	-1001	-149	-777	-124	-1336	-257

The differences between the impact on POCL and PO are the impacts on Royal Mail, PFWW and Group (interest and tax).

Therefore, in terms of relative positions, continuing Horizon is least bad.

## 6. Recommendations

The Board is invited to note:

- (i) the impacts of continuing or terminating Horizon;
- (ii) that continuing, while bad, is better than termination.

The Board is asked to agree to:

- (iii) the signing of the revised contract with ICL following a codification of the 24 May 1999 Heads of Agreement, and the associated payments to ICL;
- (iv) interim project funding of £11.03m until a formal MaPEC in September.

The Board is asked to agree that work should continue on:

- (v) stopping or delaying the move to ACT;
- (vi) reducing the ongoing cost of Horizon;
- (vii) reviewing channel strategy, including its cost, alternatives and its impact on the universal service obligations of The Post Office;
- (viii) persuading Government to ring fence the Horizon costs from other Post Office business; and
- (ix) how the Government could subsidise the nation-wide network.

Stuart Sweetman  
July 1999