



BF with responses from
ex, cl/ex, SS/LPI
NO comments AT 22/7

PRIME MINISTER

LOCAL OFFICE PROJECT

I have been considering how we should approach the procurement of mainframe computers for my Department's Local Office Project (LOP). This is a key element in our plans, highlighted in the Social Security Green Paper, to modernise the administration and delivery benefits. I have concluded that the balance of argument lies with a single-tender approach to ICL and accordingly seek the agreement of yourself and of colleagues on E(A) Committee.

The key issue is, of course, the justification for single-tender procurement under EEC and GATT rules. The Solicitor General has considered this and, I understand, advises that there is good justification under the exceptions relating to technical compatibility with existing computer systems. Officials have prepared a detailed analysis of the issues involved and their paper is attached.

My main concern is that we should provide ourselves with the technical scope for integration of the various benefit systems (including the system supporting unemployment benefit staff in the Department of Employment) by ensuring that the Local Office Project computer mainframes are fully compatible with the ICL systems already in use. Looking further ahead, we have highlighted in the Green Paper the need for technical compatibility between the social security system and that of the Inland Revenue - who are, of course, already planning to use ICL. This is the approach which underpins our plans to provide a more comprehensive service to social security beneficiaries and to keep open future options for closer integration between tax and social security.

There are other significant advantages for DHSS in continuing to procure computer mainframes from ICL. The Department's technical

E.R.

expertise in this area lies solely with ICL; adopting a common supplier for all the Department's large systems increases our internal flexibility and provides greater resilience in the event of a loss of service at one of our installations. The Department's total current investment of some £50 million in ICL-based software would not be transferable to another type of machine if we sought to achieve integration around a different hardware standard, chosen from the competitors for an open LOP tender. Moreover, leaving aside the question of any possible delays in the delivery of acceptable equipment, an early decision on the mainframe manufacturer will reduce the development time needed to introduce the project.

We also need to take account of the major commercial significance of the LOP contract to the future of ICL - a point which I know is of concern to Norman Tebbit. The award of a contract of some £30 million for the new range of ICL computer mainframes would show Government confidence in the company and its new machines. Failure by them to obtain the award would be a serious blow and would call into question the substantial Government support to the company since 1981. We must, of course, be conscious of the very substantial market penetration of IBM - the major threat to ICL and indeed to other computer manufacturers. There are inevitably some disadvantages in proceeding through single tender from ICL. The new range of ICL computer mainframes is less powerful than other existing machines and is not yet fully proven. And IBM in particular has considerably more experience in the provision of major systems involving very large networks. There can be no doubt that the competitive process would ensure that we achieved the lowest price in respect of this particular mainframe contract. And the choice of IBM-compatible mainframes would make available to us the very wide range of products that have been developed by third parties. To avoid any risk that the lack of an already proven ICL product might delay the project, it will be essential to satisfy ourselves that the company is adequately controlling the quality of its products; and to ensure that, as far as possible, any financial penalty arising from late delivery or poor performance falls on ICL. This is the approach which, I understand, has been followed very successfully by the Inland Revenue.

is the Solicitor General getting cold feet?

I have, of course, looked closely at the legal implications of adopting a single tender policy. I am advised, and I understand that the Solicitor General concurs, that the exceptions under the relevant EEC Directive and GATT Government Procurement Agreement justify such an approach. The justification flows from the need to ensure full compatibility with other ICL systems both for the present and so as to secure integration in the future. Thus there is a specific requirement for certain precisely defined technical characteristics which could not be met by other suppliers without infringing ICL's exclusive rights. In addition, it can be argued that the purchase of equipment with different technical characteristics from our existing equipment would cause disproportionate operational and technical difficulties.

ie tax/benefit

It must be recognised that future plans for integration are not as persuasive a justification as immediate technical requirements. *ie, rationalisation of the different benefits.*

The strength of the case is thus proportional to the Government's commitment to integration of benefit systems. It is possible that other interested companies (notably IBM) might challenge the decision in the European or domestic courts by a claim, firstly, for a declaration that the Government was acting unlawfully in not inviting competitive tenders and, secondly, for damages. Furthermore, single tender might be challenged by the European Commission of its own initiative, or following complaint by a competitor: if the Commission was not satisfied with our explanation it could bring the matter before the European Court of Justice alleging a breach of community law. The chance of an adverse finding by that court cannot be entirely excluded. Nevertheless, I conclude that the case in favour of inviting a single tender from ICL outweighs such a risk and that we should adopt this policy, subject to the company giving guarantees about performance.

I should add that there is some urgency about this issue. Delay of LOP, and of its substantial improvements in efficiency and service which we have presented in parallel with the Benefit Review, have both financial and political consequences which we should seek to avoid. I hope therefore that we can agree my proposal in correspondence, but I understand that E(A) will be meeting on 29 July when we could, if necessary, discuss the matter. Perhaps I might therefore ask for responses from colleagues by 25 July?

E.R.

If you are content with my recommendations, I would propose to discuss with Norman Tebbit and the Chancellor the most appropriate time and manner for announcing the decision, once formal approval to proceed with the project itself has been given.

I am copying this to members of E(A), Sir Geoffrey Howe, Sir Michael Havers, Sir Patrick Mayhew and to Sir Robert Armstrong.



N F

19th
July 1985

CONFIDENTIAL

MAINFRAME PROCUREMENT POLICY

DEPARTMENT OF HEALTH AND SOCIAL SECURITY

LOCAL OFFICE PROJECT (LOP)

INTRODUCTION

1.1 The aim of this paper is to present the arguments for and against placing a non-competitive tender for the mainframe computers for the Department of Health and Social Security's local office computerisation project. It will be argued that the balance of advantage for Government lies with placing a single tender to ICL and that this action is in accordance with EEC regulations for Government procurement and within the principles of the GATT agreement.

1.2 The recently published Green Paper "Reform of Social Security" outlined the Government's bold plans for major reforms in social security provision. An important underlying objective in the proposals is the desire to streamline the benefit structure and simplify and improve its administration. A good deal is made in the Green Paper of the need to use fully the opportunities presented by modern computer technology. If this is to be achieved it will be necessary, as described below, for there to be a coherent and integrated approach to the planning and development of computer systems over a number of years.

BACKGROUND

2. The Operational Strategy

2.1 A discussion paper "Social Security Operational Strategy - A framework for the future" was published in 1982. Publication was followed by detailed and widespread consultation within Government and with representatives of Industry, Commerce, the Trade Unions, and others, which resulted in a general endorsement of the objectives and approach of the Strategy.

2.2 The Strategy aims to modernise, simplify and unify the means of delivery of benefit, to give a greatly improved public service at reduced cost. A number of separate projects will be undertaken, within the framework of the Strategy, taking on board the changes proposed in "Reform of Social Security." These will be concerned with modernising and integrating the delivery of income support, Unemployment Benefit, Retirement Pensions, Child Benefit, Contributions Records, and other features of social security. These will be so designed as to be completely compatible, allowing

convergence on what has been described as the "whole person" approach - the ability to deal with an individual simultaneously across all benefits and thus get away from the present diversity of methods of claiming, assessing and payment of benefit. The present system is as confusing to the public as it is complex in operation.

2.3 The two objectives - to converge on a unified method of delivery of benefit and to accommodate, indeed to facilitate, legislative change - mean that it is no longer possible to design and implement benefit systems independently. The different computers that serve different benefits must fit closely together and be developed to common standards and common designs.

3. The Local Office Project (LOP)

3.1 This project is a major element of the Strategy. It will provide, for the first time, comprehensive automated assistance to the system of income support which will replace Supplementary Benefit. Some 19,000 computer terminals will be provided in 500 local offices. They will provide the clerks in those offices with a means of rapid and accurate assessment of benefit, immediate access to claimant records and an automatic initiation of payment. This will greatly improve the service to the public while providing a better, more modern environment for the staff.

3.2 The project requires three main technical components: terminals and associated controllers for the local offices; a communications network to link them together; and mainframe computers to carry out the processing of data. The first two components will be specified to international standards and will be procured by competitive tendering. The mainframe computers which support this network are an open question.

3.3 The initial contract value is approximately £30 million for mainframe computers and some £40 million for terminal systems. Interested vendors for the mainframe systems are ICL, IBM, Honeywell, Sperry and Amdahl, all US owned companies with the exception of ICL. IBM and Honeywell have a significant manufacturing capability in the UK but their corporate roots are unquestionably in the US.

3.4 The project is, in itself, cost effective. On present estimates it will yield some 700 manpower savings in its first year of implementation 1989/90 rising to 8,500 posts or about £100m per year by 1994/95.

3.5 The Treasury have authorised continuation of the project but have yet to authorise the commencement of formal procurement.

4. Procurement Policy

4.1 Government procurements such as that of LOP mainframes are subject to EEC and GATT rules which, in general, require open competition between manufacturers. However, there are various exceptions which allow limited, or single tendering where there is a requirement for technical features which are the exclusive property of a particular manufacturer; or for compatibility with existing systems. The legal issues are discussed in detail in Annex A.

4.2 The most effective test of value for money in computer equipment is a properly staged, thoroughly analysed, competitive tendering process. In looking at value for money in LOP, however, the issue is wider. This is because LOP is neither the first, nor the only, computer project within the DHSS strategy for information technology. The LOP mainframes will be required to participate in a wider network of computer processing which already exists, and which is planned to expand in its scope and inter-working.

4.3 Notwithstanding the arguments for single tender in this instance, the general policy of the Department is to seek the best value for money through competitive procurement. This has indeed hitherto been the Department's stance on LOP, and despite the different approach for LOP mainframes proposed here, major contracts within the Strategy have already been awarded after evaluation of competitive bids. Honeywell have gained a contract to supply terminal systems for the Unemployment Benefit system worth £33 million. British Telecom won the contract for the Local Office Microcomputer Project worth some £16 million. ICL were unsuccessful bidders for both these contracts. Terminal systems for all future projects, including LOP, will be put to competitive tender.

DISCUSSION

5. LOP in the context of the Departmental strategy

5.1 At the present time, ICL mainframes are used by the DHSS to process a number of benefits at five main locations: Newcastle, Washington, North Fylde, Reading and Livingston. These centres deal with unemployment benefit, child benefit, retirement pensions, national insurance contributions and disablement benefits. In very broad terms these systems represent a present capital investment in ICL mainframe hardware of £50 million and in ICL-based software of another £50 million. Plans to replace and upgrade all these systems during the period 1988-1992 have been approved by the Departmental Operational Strategy Steering Committee, and ICL mainframes will of necessity continue to be used. Use of other mainframes would require the re-writing of existing software, at very great expense, to adapt it to a different hardware environment. From the outset, LOP will need to exchange data with these systems and their replacements.

5.2 The position of LOP in the context of the DHSS's existing and planned computer systems may best be illustrated by means of the diagram at Annex B. From this it will be apparent that the LOP mainframes are a significant, but by no means overwhelming, addition to the existing network (£30 million compared to a total installed value of £50 million); and that they need to link effectively to the other ICL mainframes already in use. As the diagram also illustrates, over 80% of the 96 million records which social security computer systems will eventually hold are already held in existing computers. These records contain considerable duplication of data, and this increases costs and reduces efficiency.

5.3 The Department's strategy is firmly committed to the convergence and integration of all benefit systems in what has been described as the "whole person approach". Annex B explains in more detail the technical significance of the integration of all DHSS computer systems. The integration, and hence rationalisation, of benefit data will permit a single view of a claimant across all benefits instead of the present system of dealing benefit by benefit. This will yield greater savings and improvements in service, efficiency and resilience than can be achieved by piecemeal computerisation. Such convergence can only be achieved by close integration of these systems, and all current systems operate on ICL computers. By the same token, if the Department moved its new developments to another make of computer, this same requirement for integration would inevitably require that existing systems be moved over to that same type of computer, by single tender procurement. The difference in hardware costs would be insignificant; however, such a change would entail the waste of the entire ICL-based software investment, as all systems would need to be re-written for the new hardware environment.

5.4 Integration is not simply relevant to a reduction or elimination of duplication, but to a much wider issue. A common database and integrated software would greatly increase the options open to Government, for example if Ministers wish to consider major innovation in the areas of benefits and taxation. It is fundamental to the Department's strategy that this opportunity is not lost.

5.5 The first step towards integration is the modernisation of existing benefit systems, more or less as they stand (and the creation of the major new one - LOP), to achieve common technical standards in line with the best current practice in the industry. This means upgrading existing benefit systems, not immediately to full integration, but to the use of common operating software and communications standards, so that full integration is economically achieved in the next step. This means adoption of a standard "operating system", "database management system", software development tools etc. All of these software products relate to the specific make of mainframe in use, and themselves represent a substantial investment by DHSS which is not transferable to other manufacturers' mainframes.

5.6 The most immediate requirement for integration is between LOP and the National Unemployment Benefit System (NUBS) currently serving the Department of Employment's Unemployment Benefit Offices. Given the obvious functional similarity between LOP and NUBS the two Departments need to find the most effective way of using new technology for a social security service more integrated and accessible to the public. At present some 60% of claimants served by NUBS are also in receipt of supplementary benefit which is assessed and notified to NUBS clerically. Integration of the NUBS and LOP computers is therefore planned, and the first LOP processing centre will be provided as an extension of the existing NUBS centre at Livingston. The extent to which the DE and DHSS local office networks may eventually be merged is to be studied by both Departments in the light of the development of the computer systems, and of the implementation of the new Income Support benefit.

6. Arguments for a single tender to ICL

6.1 The principal argument is therefore the requirement for integration of computer systems. The scope for integration will be much reduced if the LOP system has a different technical architecture from the other DHSS systems. It would not be feasible to have a common database for the ICL systems and the non-ICL systems and it would not be feasible to integrate ICL software with non-ICL software. Although it may be possible for the systems to communicate using a common standard (eg Open System Interconnection), communication between systems falls far short of integration. It does not allow for parts of one software package to be merged with parts of another, for databases to be transferred, merged or split, or for common software to be run on several systems without change. A computer system for LOP with a different architecture from the ICL systems would not meet the Government's requirement for integrating the various DHSS systems and also lose the wider opportunities for flexibility and innovation in the area of possible integration of tax and benefits.

6.2 The skills, training and development methods of the Department are, so far as mainframe computers are concerned, all related to ICL systems (an investment in current ICL-based software of some £50 million). All the large DHSS installations use ICL 2900 equipment and DHSS staff are trained in and use ICL software facilities. The cost of conversion of the LOP team to another supplier's software (retraining, delay and loss of productivity) together with the cost of re-developing DHSS software aids will be high. The strategy, even if only ICL mainframe systems were to be used, will place great demands on these skills and technical resources which are already in very short supply. The technical difficulty and cost of developing and maintaining systems in a mixed hardware and software environment would be very much greater. It would seriously extend and complicate

the planned programme of work and make it very difficult to redeploy staff skilled in the use and development of one computer system to work on another.

6.3 Flexibility is a key requirement of the social security system. It is always open to further improvement, to better targeting of need, and even further simplification and rationalisation. It is essential that the systems developed under the Strategy are flexible enough to cope with rapid change - changes that may merge benefit systems, further simplify and rationalise benefits or even integrate them with taxation. The best use of computer hardware will be achieved if, in the face of rapid and, at this stage unpredictable change, all the mainframe computers are architecturally identical so that any machine can take on any task - work can be switched between machines, or records or functions can be merged. This is only possible if all mainframes are of the same type in respect of their hardware and software.

6.4 A further key requirement is the resilience to deal with a complete loss of service at mainframe computer installations. Industrial action is the most likely cause of this and the recent Newcastle strike has demonstrated the present system's vulnerability. Switching work to unaffected sites increases the ability to maintain a service. Again, this form of resilience is only possible if machines of the same hardware and software characteristics are used.

6.5 The timescale of the project can be reduced by proceeding directly to a single ICL tender. The cost of computers and peripherals at the computer centres represents under 20% of development and capital costs. On current planning assumptions a single tender decision would shorten the development time - saving perhaps £1m; but of much greater significance bring forward by several months the time at which staff reductions can be achieved. This would save some £8 million a month, eventually, and puts hardware price differences of the order of perhaps £5m into perspective.

6.6 The ability to build early prototypes on the eventual supplier's equipment will significantly reduce the design and development risks of the project. The plans for LOP development and implementation include a process whereby the system is gradually developed through representations of the LOP system, concluding with a full LOP prototype at up to 20 local offices. The first stage in this is already under way, involving testing VDU screen formats. A single tender decision would enable the project to move swiftly into developing the prototype systems on ICL facilities which would be the eventual basis for a full prototype, thus providing reassurance on project timescales and confirming the functional design. This would give the best means of designing effective clerical interfaces with the new system, creating effective operational procedures, and confirming staffing assumptions.

6.7 The LOP contract is one of major commercial importance to ICL. It coincides with the launch phase of ICL's new large 'Estriel' mainframe computer range, one of the main elements in ICL's recovery plan which followed the Company's rescue in 1981 with the help of a £200m loan guarantee. Loss of the contract for the Government's largest mainframe requirements in the later 1980s would be read by the rest of the market as meaning that Government had serious reservations over Estriel's effectiveness and ICL's future as a mainframe supplier. This would be a serious blow to ICL which could precipitate a wider loss of confidence, leading to ICL's mainframe customers in both the public and private sectors switching to the US multinationals, particularly IBM, for their requirements. This would be bound to increase IBM's already substantial market penetration in the UK.

6.8 ICL will remain dependent for a long while to come on revenues from mainframe computer sales, in order to finance expansion into new market sectors such as office automation and networked systems. Mainframes directly provide about 40% of ICL's revenue, and many smaller products are sold for connection to them. Their contribution to profits is very much higher, probably more than 60%. The Company's financial position is still uncertain despite the takeover by STC (itself less well-placed financially as a result of the acquisition, and the loss of business with BT). An unsuccessful launch of the Estriel would be potentially disastrous, and would call into question not only the support totalling £16.8m which DTI has committed to ICL mainframe systems development since 1981, but also the maintenance of the company as the sole UK-owned mainframe computer supplier. On the other hand, the prospects for worldwide sales of Estriel mainframes are fairly promising if the UK market confidence in ICL is maintained; the VME operating system which it uses is technically more efficient than those of IBM or its other competitors, and has considerable potential for further development.

6.9 The total future requirements of the strategy, which will include a large centralised index, are estimated to be between 8 and 12 large computer mainframe installations. After LOP has been installed, the same arguments for compatibility used above will then result in considerable pressure to replace by single tender all these systems with the same mainframes as those for LOP. Thus, if say IBM won the LOP mainframe contract the Department would want to procure the replacement NUBS system from IBM also, and then to gradually replace other ICL mainframes from the same source.

6.10 The long-term industrial importance of seeking to preserve ICL as the UK's only indigenous mainframe computer supplier is hard to assess. The US-owned multinationals, particularly IBM, make a substantial contribution to the UK economy, (exceeding ICL's in terms of investment and jobs), while ICL is in many areas heavily dependent on US and Japanese technology. ICL's parent STC retains close links

with the US corporation ITT, which still has a substantial minority shareholding. There are no significant implications for the UK's defence capability.

7. Arguments against a single tender to ICL

7.1 There are risks in going to ICL, whether by single or open tender. ICL is a very small company compared with IBM whose enormous R&D budget (around £15 billion over the past 5 years) is reflected in their product line. The large computer mainframe market is totally dominated by IBM; any other supplier can only hope to gain a small share of the world market. Although ICL has a significant share of the UK market, their world share is very small indeed and shrinking. It is therefore not impossible that they will, in the long term, be forced out of the mainframe business. The consequences of this for Government would extend well beyond the boundaries of DHSS!

7.2 The new ICL product 'Estriel' is in fact a less powerful machine than some of the larger existing computers of IBM or other possible competitors, and is as yet unproven. The recently announced new range IBM machine, due in two years' time - the 'Sierra' - is very much bigger still. IBM software is in general well advanced and more reliable than ICL's, although some key ICL products are more technically advanced. In the key area of 'networking' - the ability to interconnect computer systems - all the other potential bidders, including IBM, have much greater experience of large networks and in general can offer more proven products. (This disadvantage could partly, but not entirely, be reduced by using non-ICL products for interconnection between systems.)

7.3 Furthermore, ICL have a reputation for well engineered and designed products but delivered late and with many of the software faults which ought to be eliminated by good quality control, left for the customer to discover. If a contract of this magnitude is delivered to ICL then Government must be assured that quality control of software is adequate and, more importantly, that any financial risks attendant on late or faulty delivery, or miscalculation of the size and power of the mainframe systems, fall on ICL and not on the Department. It will therefore be essential to ensure that any decision on single tender to ICL should be conditional on enforceable guarantees about the performance of their equipment. However, most of the relevant components will have been subjected to intensive validation trials in which ICL are working closely with CCTA and Inland Revenue, and will be evaluated by the COP project and other DHSS projects before they are required by LOP. There will therefore be a very much clearer view of the reliability of the Estriel hardware and software well before DHSS is finally committed to it for LOP.

7.4 It is arguable that complete dependence on one supplier for all Departmental mainframes is unwise and that putting "all the eggs in one basket" is to be avoided.

7.5 Because of IBM's almost total dominance, there is a wealth of IBM compatible software and hardware products on the market. There is no comparable commercial advantage in building ICL compatible products and an ICL contract (or any other vendor than IBM) would shut the Department off from this range of third party products.

7.6 Compatibility can be achieved, although to a lesser degree than that described in para 5.4, by adherence to common standards for interconnection of the mainframe computers. This would allow the different benefit systems to transfer information but would not allow functions to be transferred between computers of different manufacture nor permit integration of the computer files. Integration with Unemployment Benefit (and with taxation) would be prevented, and eventual convergence on an integrated 'whole person' view of benefit would be hampered; and there would be less flexibility and resilience. However, a system could be built which would be effective and operable. The standards specified for interconnection are the standards for open systems interconnection laid down by the International Standards Organisation (ISO). IBM normally market a different proprietary set of standards but it is believed they would offer the ISO standards in an attempt to win this bid.

7.7 The earlier policy of Government protection has not improved the quality and competitiveness of ICL's products. It is important, therefore, if the LOP project does proceed by single tender to ICL, that this should not be seen as a return to a generalised policy of preference.

7.8 Challenge by a competitor of ICL's on the grounds that single tender procurement contravenes EC and GATT regulations cannot be ruled out. The legal issues and the scope for a legal challenge are discussed in detail in Annex A. In the opinion of CCTA officials, only IBM is likely to consider challenging the decision, and even then it is unlikely that they would do more than vociferous lobbying. Ministers will need to be aware of this risk, and to consider their response to "sabre-rattling". Abandonment of a single tender policy for the LOP mainframes at the first sign of dissent would be worse than not adopting the policy in the first place.

SUMMARY

8.1 The principal argument in favour of single tender is based on planned integration of computer systems and hence the need for compatibility of the LOP system with existing and future benefit systems.

8.2 The timescale of the project would be reduced by several months by proceeding by single tender.

8.3 There are also strong grounds for protecting the commercial future, without 'featherbedding', of the only UK mainframe manufacturer, ICL. A mainframe capability is a key component of a domestic Information Technology industry.

8.4 The major argument against this line of action is that greater technical confidence and possibly better value for money, in the narrow sense of the price for the mainframe systems themselves, would rest in a contract with another vendor, probably IBM.

8.5 There could be some risk to the project timescales if key ICL products are delivered late or with residual technical problems, and to its eventual successful delivery if ICL systems are not proven in practice.

8.6 There is an arguable case in law for single tender action to the extent that Ministers are committed to the integration of benefit systems.

8.7 The case might be challenged - particularly by IBM.

8.8 The balance of advantage to Government lies with single tender to ICL.

LEGAL ISSUESA1 General

A1.1 The CCTA and the DHSS (the "Relevant Authorities") are subject to EEC Directive 77/62 (as amended by EEC Directive 80/767) and to the General Agreement on Tariffs and Trade - Multilateral Trade Negotiations Agreement on Government Procurement. However, for the reasons set out in the Appendix it is highly unlikely that the GATT Agreement could be invoked directly in proceedings in a United Kingdom Court.

A1.2 The overall purpose of the EEC Directive and of the GATT Agreement (the "Regulations") is to harmonise procedures relating to public supply contracts and to introduce equal conditions of competition for such contracts in the territories of the contracting parties. The Regulations set down tendering procedures and the conditions on which public supply contracts may be awarded to ensure that foreign suppliers are not discriminated against. They require, as a general rule, that suppliers from other states should be given an opportunity to tender for public supply contracts on equal terms. Both the EEC Directive and the GATT Agreement provide, however, for exceptions to this general rule and thus permit contracting states to proceed by way of single tender to one supplier where certain conditions are fulfilled.

A1.3 There are two exceptions under the Directive and the GATT Agreement on which the Relevant Authorities can seek to rely to justify single tendering in favour of ICL for the LOP project.

A2 Exclusive Rights or Technical Reasons Exception

A2.1 Under Article 6.1(b) of EEC Directive 77/62: "contracting Authorities may award their supply contracts without applying the [normal tendering] procedures referred to in Article 4(1) and (2) in the following cases:...

- (b) When, for technical ... reasons or for reasons connected with protection of exclusive rights, the goods supplied may be manufactured or delivered only by a particular supplier;"

A2.2 This exemption envisages the possibility of a public authority awarding a contract on the basis of a single tender where the operational requirements can only be met by one supplier for purely technical reasons and/or for reasons relating to proprietary rights. If Ministers require to achieve a much closer technical integration of the various benefit systems or of the taxation system, then the Operational Requirement for LOP must be written around the general specifications necessary to ensure compatibility between the architecture of the LOP system and of the other

DHSS systems. There are objectively justifiable reasons for basing the technical specifications for the LOP system on ICL architecture: namely, the need to give Ministers the means for integration spelt out in section 5 above. If the operational requirements were so written, only ICL could meet the technical requirements of the tender and therefore single tendering would be justified for technical reasons.

A2.3 Similar arguments apply if Ministers wish a more radical innovation in the area of taxation and benefits. In general, however, the strength of the legal justification for single tender procurement is directly proportional to the Government's commitment to the integration of computer systems. Thus the case rests on the integration of benefit systems, as outlined most recently in the Green Paper "Reform of Social Security". It should be pointed out in this context that it must be regarded as uncertain whether the exception for technical reasons or the protection of exclusive rights could successfully be invoked to cover a desire to retain an option to integrate, as opposed to the purchase of equipment required for definitely planned integration.

A2.4 In addition, single tendering would be justified under this exception if the operational requirements were so written, because no other supplier could meet the operational requirements without infringing ICL's exclusive rights. Those requirements would necessarily specify ICL architecture. Such architecture is based upon, and indeed defined by, ICL's proprietary VME operating software, copyright in which is vested in ICL. No other supplier has the right to use or license others to use VME, nor does any existing supplier provide hardware on which the VME software can operate.

A2.5 With reference to Article 7.(2) of the Directive, (to which single tendering is subject by virtue of Article 4(3) of the Directive), the reference to ICL architecture in the operational requirements will be justified by the subject of the contract: that is the need to have a system for LOP which will meet the requirement of integration with other DHSS systems.

A2.6 Under the equivalent exemption in the GATT Agreement, (Article V 15(b)) single tendering is justified where: "...for reasons connected with protection of exclusive rights, such as patents or copyrights, [whereby] the products can be supplied only by a particular supplier and no reasonable alternative or substitute exists". Although this exception in contrast with the EEC Directive does not refer to "technical reasons" it does provide that "...reasons connected with the protection of exclusive rights"... can justify single tendering. For the reasons set out in para. 15.4, therefore, Article V,15(b) of the GATT Agreement can also be relied on.

A3 Compatibility Exception

A3.1 In addition to the technical reasons and exclusive rights exception, and as an alternative ground, the Relevant Authorities can seek to justify single tendering to ICL on the grounds of Article 6.1(e) of the EEC Directive. Article 6.1(e) provides that the Relevant Authorities may award their supply contracts without applying the EEC Directive's procedures if such contracts are "for additional deliveries by the original supplier which are intended....as the extension of existing supplies or installations where a change of supplier would compel the [Relevant Authorities] to purchase equipment having different technical characteristics which would result in incompatibility or disproportionate technical difficulties of operation or maintenance."

A3.2 The LOP system is not the first DHSS computer system. The acquisition of the LOP mainframes has to be seen in the context of existing DHSS computer installations. To regard the LOP system as a completely separate installation is to ignore the fact that first, the LOP system will be dependent on, and will want to use, information processed by other computer systems within the DHSS and, secondly, that the LOP system will subsequently be integrated with those systems. In view of the intention that the LOP system should be integrated with existing computer systems within DHSS, it can be argued that it should be regarded as an extension of those existing installations. However, since the LOP system would at the outset be operating independently, clearly a contrary argument could be raised that such an intention was not sufficient to bring the supply of the LOP mainframes within Article 6.1(e) of the Directive. Paragraph 5.5 above explains how such a period of independent operation is a necessary step towards integration.

A3.3 A risk of which Ministers should be aware is that a competitor of ICL might seek to argue that the proper course for DHSS to follow would be to put the supply of LOP mainframes out to open tender and then move to integration with the most advantageous of the systems offered by the suppliers who tendered. To counter this it could be argued, however, that the existing DHSS mainframes, being ICL, have "different technical characteristics" (ie a different architecture), and that this would give rise to "incompatibility" and "disproportionate technical difficulties of operation" in that the DHSS staff involved are all trained exclusively in the use of ICL hardware and software, and write their own user software for the ICL systems (see paragraph 5.3 above).

A3.4 The equivalent exception in the GATT Agreement, Article V,15(d) can be relied on by the Relevant Authorities for similar reasons. The award of the LOP contract to a non-ICL manufacturer would constitute "a change of supplier [which] would compel the [Relevant Authorities] to purchase equipment not meeting requirements of interchangeability with already

existing equipment." It is evident that ICL equipment and existing installations will not be "interchangeable" with non-ICL equipment supplied for LOP given the absence of a common technical architecture.

A4 Possibility of Legal Action

A4.1 Notwithstanding the foregoing analysis which indicates that an arguable case exists in law for single tender, there is no guarantee that other interested companies, IBM in particular, would not challenge the single tender decision in the domestic courts. A competitor of ICL might bring an action against HMG in order to obtain a declaration that HMG was acting contrary to community law and the Supplies Directive in particular in not going out to competitive tender. A competitor might also bring a claim for damages based on such an infringement. An action for damages would be novel in that it would be based on a failure to comply with a directive, but the domestic courts have already entertained such an action based on infringement of an article of the EEC Treaty (Bourgoin v Ministry of Agriculture Fisheries and Food, Judgment under Appeal). There would be difficulties of proof of the amount of damages but this would not affect the Court's attitude to liability.

A4.2 If a competitor succeeded in bringing a damages claim before the domestic courts and in establishing liability, the amount of damages for which HMG would be at risk would depend on a number of factors. If the competitor could show that it would have put up a better tender (ie one which was financially more beneficial to the Department and met the necessary technical and other requirements) then the court could be expected to award damages calculated by reference to the loss of profit. A competitor's position would be weaker if there were a number of alternative potential tenderers since then the court would have to bear in mind the possibility that the contract would not necessarily have gone to the claimant competitor. The fact that a competitor would be prepared to tender at a loss, in the expectation that if it won the contract it might make other more remunerative contracts later on, would also be a factor which the court would have to consider, whether the claimant was the sole competitor or one of a number.

A4.3 Although no formal power exists for any court to hold up procurement action (by injunction, for example) the Law Officers would normally wish the Government to behave as if such a power existed, and delay action until the matter is settled.

A4.4 Any question on interpretation of the provisions of EEC Directive 77/62 arising in such proceedings would be likely to be referred to the European Court of Justice for a preliminary ruling on it, which would then be binding on the court here which would proceed to deal with the case on that basis.

A4.5 The compatibility of the single tender procedure with the Supplies Directive and Community law generally could also be raised directly in the European Court of Justice by infraction proceedings brought by the European Commission (or, very much less likely, by another member state). If the court upheld the Commission's case that single tendering was not justified by the particular exceptions in the Supplies Directive, it would declare that the United Kingdom had failed in that respect to comply with its treaty obligations. It would then be necessary to consider what measures were required to comply with the judgment and this could involve the provision of some form of remedy for those adversely affected by the breach, although this would also depend on consideration of domestic law as well.

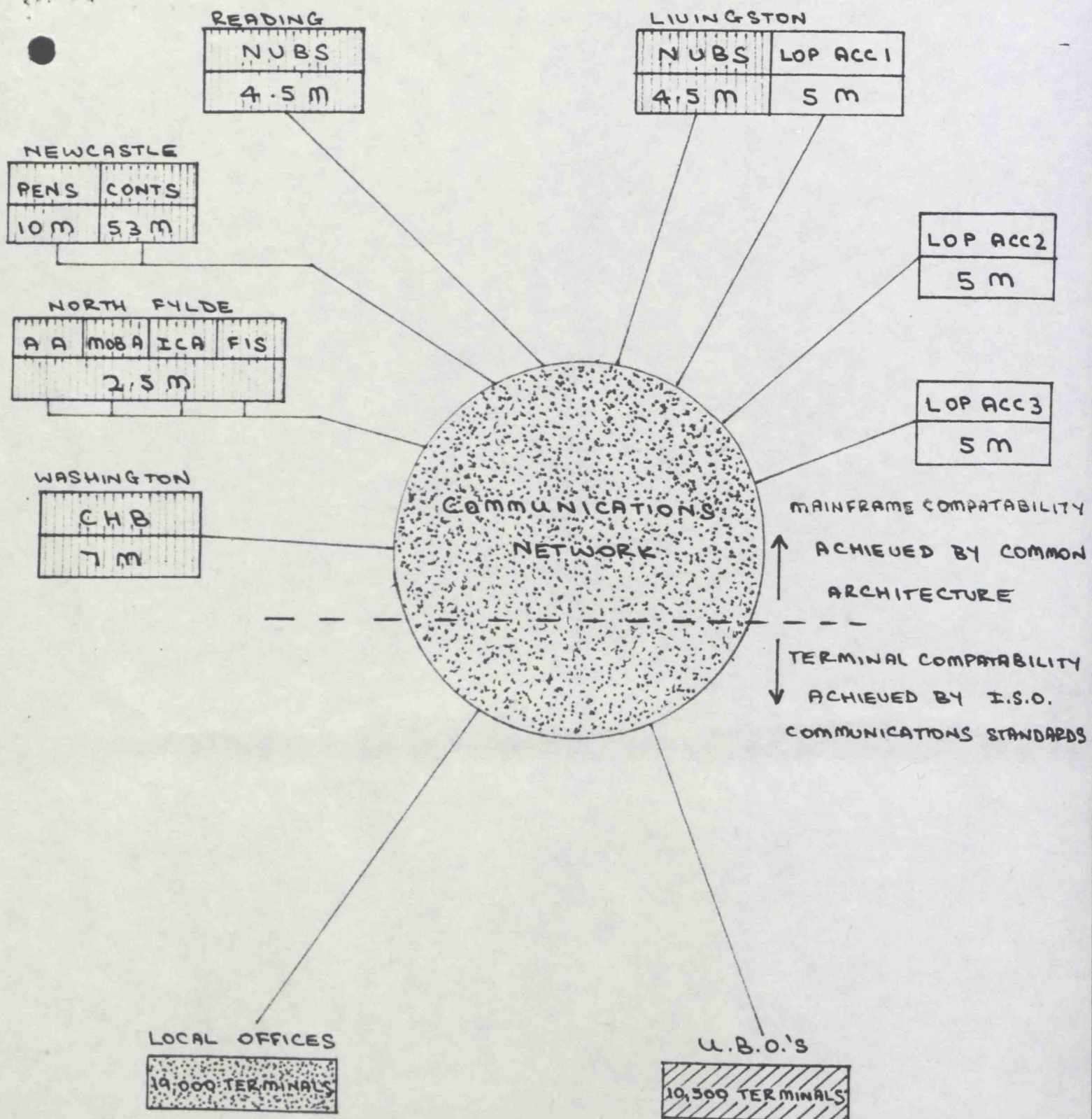
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Direct Effect of Gatt Agreement

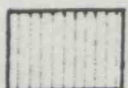
It is highly unlikely that the provisions of the GATT Agreement could be invoked by any private party in proceedings in an English Court. As a matter of domestic law, it could not be invoked directly. As a matter of European Community law, the European Court of Justice has decided in five cases that various provisions of GATT cannot be invoked by parties in national proceedings to challenge the validity of either EEC or national decisions or measures (see Cases 41-4/70 International Fruit Company, [1971] ECR 411, Case 9/73 Schlüter, [1973] ECR 1135, Case 266/81 S.I.O.T., [1983] ECR 731, Cases 267 to 269/81 S.P.I. and S.A.M.I., [1983] ECR 801 and Cases 290 and 291/81 Singer and Geigy, [1983] ECR 847. In those cases the Court decided that the relevant provisions of GATT were not directly applicable for reasons concerning the nature of the GATT Treaty which appear to be of general application to GATT Agreements. This view appears to be supported by Advocate General Reischl's Opinion in the S.I.O.T. case at p.790.

'WHOLE PERSON' NETWORK

1. The long term goal (to be achieved by the mid-1990s) is that both the public and the policymaker shall have a single, comprehensive and consistent view of an individual's social security business.
2. To move efficiently to this situation without having constantly to replace large sections of the computer systems - and, in particular, their software programs and records (which are far more durable than the hardware) - requires careful planning. The aim is progressively to converge on this goal as the present systems are modernised and as new ones are introduced (in particular, the Local Office Project).
3. The figure shows a schematic of this plan. The present ICL-based Contributions, Child Benefit, Retirement Pensions and Unemployment Benefit systems will be modernised, building as far as possible on what exists, and the new Local Office Project will be integrated into the mainframe community.
4. Eventually the objective is that this central mainframe community will form a common pool of computer resources. The present allocation of mainframes to specific benefit processing tasks need not necessarily persist and future tasks may be allocated where machine resource is available. Changes in the form or volume of benefit processing due to changes in policy may completely alter the balance and geographic distribution of computing requirements. (A complete technical integration of the Unemployment Benefit files and the Income Support files, for example, would possibly lead to five integrated centres instead of 3 LOP and 2 NUBS centres.)
5. It is a Departmental requirement to converge eventually on this form of common, technically consistent, central mainframe pool - and with present technology this can only be achieved using mainframes from a single manufacturer.
6. The figure also shows how these will be connected as a common pool of mainframe power through an international standard network to standard terminal systems in local offices. The Unemployment Benefit offices, having started procurement before the strategic standards were developed, will be supplied with Honeywell UK terminals. The eventual intention, however, is to use standard terminals throughout.
7. Provided all terminals are of a standard type and communicate by International Standards, there is no requirement for them to be from the same supplier as the mainframes, for they use quite different software.



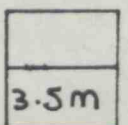
= TO BE PUT TO OPEN TENDER



= EXISTING I.C.L. EQUIPMENT



= NON-I.C.L. EQUIPMENT ALREADY OBTAINED BY OPEN TENDER



= NO. OF RECORDS HELD IN EACH SYSTEM (MILLION)

