

In Strictest Confidence

POLB05(6TH)
POLB 05/91 – 05/115

Post Office Limited

(company no. 2154540)

Minutes of the meeting of the Board
held at 80-86 Old Street, London
on October 19th 2005

Present:

Sir Michael Hodgkinson	Non-executive Chairman
David Mills	Chief Executive (for POLB05/92 – POLB05/106)
Ian Anderson	Human Resources Director
Alan Cook	Non-Executive Director
Peter Corbett	Finance Director
Ric Francis	Operations Director
Brian Goggin	Non-Executive Director
Graham Halliday	Banking & Financial Services Director
Allan Leighton	Chairman, Royal Mail Holdings (for POLB05/92 – POLB05/106)
David Miller	Chief Operating Officer
Gordon Steele	Marketing & Direct Sales Director

In attendance:

Jonathan Evans	Company Secretary
Ian O'Driscoll	Commercial Director (for POLB05/104)
Neil Owen	Notes
Derek Rocholl	Category Manager (for POLB05/114)
David Smith	IT Delivery Director (for POLB05/104)

Apologies: None

POLB05/91 MINUTES OF PREVIOUS MEETINGS POLB(05)6TH

- (a) The Board approved the minutes of the Board meetings of 17th August 2005.

POLB05/92 STATUS REPORT POLB(05)75

- (a) The Board noted the report, and in addition:
- (b) Legal advice concerning Network Access: Gordon Steele reported that a legal view from Group had been requested, concerning Postcomm's preference to open up the branch network to competition. A response was expected shortly from Stephen Agar. Postcomm had been advised by their own

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experts that this was within their authority;

- (c) High Value Mails Products: Ric Francis underlined that it would be crucial for Post Office Ltd to be involved in delivering this. Gordon Steele assured the Board that the appropriate steps had been taken with Alex Batchelor, Royal Mail marketing director.

POLB05/93 CHAIRMAN'S BUSINESS – POLB(05)76

- (a) Mike Hodgkinson reported that he would raise issues for discussion under the Business Performance Review.

POLB05/94 CHIEF EXECUTIVE'S BUSINESS – POLB(05)77

- (a) David Mills reported the following matters to the Board:
- (b) Credit Card Launch: The launch had gone well with coverage had been given on Channel 4 News, BBC News 24, BBC 2 Working lunch. Interviews had been given with Rose Murray West and Christine Buckley, but no specific articles had appeared as a result;
- (c) Quarterly Shareholder Meeting: A meeting had taken place with Mark Higson and Stephen Lovegrove which has now led to the introduction of due diligence meetings for the funding discussions – initial meetings took place on 11th and 12th October;
- (d) Roy Keenan: A formal meeting had taken place with Roy Keenan, who had expressed concern at the rate of franchising and sales volumes;
- (e) Camelot Board: Peter Middleton was proving his worth and had helped arrange meetings with Tony Blair and Gordon Brown. Lord Coe had expressed concern that the Olympics could lose £750m if the lottery franchise changed;
- (f) CMA/CWU Strategic Involvement: Meetings had taken place with Andy Furey, Ian Ward, and Norman Candy from the CWU. A further meeting had taken place with Tony Harris, Phil Pinnel and Bobby Irvine from the CMA;
- (g) RADAR Conference AGM: RADAR had been nominated for the 'People of the Year Award';
- (h) Project Rainbow:
 - (i) Director Recruitment: Four candidates had been considered for Project Rainbow and a favourite had emerged. Tony McCarthy and the Remuneration Committee would need to approve the candidate chosen;

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- (ii) Programme Progress: The streams had been refined and this would result in Sue Huggins taking responsibility for channel strategy as well as network design;
- (iii) Plans: A presentation would be made to the Post Office Ltd Executive Committee on 7th November to outline the latest status. A further presentation would be made to the Board on 5th December.

- (i) the Post Office of the Year Awards would be taking place on Friday 21st October 2005.

POLB05/95 PR REPORT POLB(05)78

- (a) The Board noted the report.

POLB05/96 BUSINESS PERFORMANCE POLB(05)79

- (a) Peter Corbett provided the Board with a presentation on Period 6 business performance, and in addition circulated 2 handouts detailing Financial Services product income and Focus Product Income. The Board noted the presentations, and in particular that:
- (b) Period 6 Year To Date Profit after Group Allocation and Pensions costs was a loss of £57.2 million. This was £10.9 million better than plan and £1.3m lower than the previous year;
- (c) income was £1.4m worse than budget due to lower than planned sales of Telephony, Bill Payments, NS&I, Financial Products and Retail offset by a better than plan performance on Direct Payments, Mails and Motoring. The share of operating loss in POFS was adverse to plan due to the sales performance of POFS products. The share of Operating Profit in FRTS was favourable due to better margins;
- (d) staff costs were £1.0 m higher than plan due to higher than anticipated pay award settlements. Agents' costs were £2.5m lower than budget due to the impact of lower sales and the sales mix. Non-staff costs were £1.1m under budget due to reductions in spending across a number of headings (consultancy, marketing, computers, consumables, and staff related). Lower losses than plan were offset by higher EDS costs and Home Phone costs of sales (both sales volume related). Group allocations were lower than plan because of a large credit item (which will disappear by year end) in line with the change to International Accounting Standards;
- (e) half year profit before tax was a loss of £75.6 million, £27.8 million favourable to budget and £24.4 million higher than the previous year. The variance against prior year was due to exceptional items, mainly severance (£2.0m) and impairment

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costs (£7.5m), £6.6m lower profits from assets sales and higher interest expense (£9.5m);

- (f) the cash flow year to date was an outflow of £54m. This was £23m better than plan, due to the reduction in the network cash balances and capital expenditure;
- (g) the Focus Products were £4.4m below plan year to date, with a full year forecast of £12.3m variance against plan. A recovery plan is in place to mitigate the full year contribution impact;
- (h) the Financial Services product analysis showed a shortfall against the full year budgeted income of £15m. Furthermore the POFS forecast for 2006/07 was well below the level required by the Strategic Plan. It was agreed that continued pressure would be put on POFS to increase forecasts to acceptable levels. Plans would also be aligned with Post Office Ltd and the Bank of Ireland;
- (i) Mike Hodgkinson stated that it would be essential for credibility of the Board to demonstrate that it could achieve stretching retail targets, rather than process large numbers of benefits transactions. The Board agreed that Gordon Steele would develop some marketing ideas to help ensure sales targets were met, and report back to the December Board. These plans would include both measures to ensure the success of financial services product renewals, and measures to increase the penetration of products within the colleague community, particularly in mail centres;
- (j) Mike Hodgkinson suggested that the implementation of dual currency cash machines could transform the way in which the public bought much of their foreign currency, and further improve Post Office Ltd's standing as a key player in this market. However, Brian Goggin reported that there was no spare capacity within Bank of Ireland to help Post Office Ltd trial dual currency cash machines, and that their own target of rolling out 1,000 such cash machines was proving to be extremely stretching;
- (k) the Board further considered the reasons for financial services products not achieving their targets, and measures that could be taken to improve the situation. David Mills reported that POFS needed to re-engineer the customer journey to improve the overall customer experience, as poor experience accounted for a significant number of failed sales. This has been identified by POFS, but would require hard work to correct;
- (l) Gordon Steele reported that several offers were being considered for colleagues including a 'Never Knowingly Undersold Guarantee' and 'Buy 12 months, get 14 months' offers. Allan Leighton stated that most colleagues would react best to straightforward offers on price. Alan Cook stated that at a former employer of his, discounts on insurance products

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actually formed part of the terms and conditions on offer in the annual pay round to unions/staff representatives;

- Action:**
Gordon Steele
- (m) Gordon Steele further reported that Direct Sales efforts were being hampered by problems with the web site, which ran on the same infrastructure as the rest of Royal Mail Group. The Board agreed that David Burden would be invited to the POL Board in December to explain how this situation was being corrected.

POLB05/97 STRATEGIC PLAN POLB(05)80

- (a) Peter Corbett provided the Board with a presentation on the Post Office Ltd Strategic Plan. It was explained that this presentation would be used in subsequent discussions with the Shareholder Executive;
 - (b) the Board discussed the macro economic factors that had influenced the results. Mike Hodgkinson explained that the disappointing sales were partly the result of a general economic slowdown and an increase in bad debts. This had affected a number of other key high street retailers, as evidenced by their reported financial results. The Board agreed that it would be imprudent to ignore these retail trends, and the £160m PBIT target should therefore be adjusted to a more suitable level to take into account these external factors. Allan Leighton stated that any adjustment could not result in the Working Capital Loan being exceeded under any circumstances, and clarified that this was more important from the Group perspective than achieving a 15% return on capital employed.
 - (c) In the light of the shortfall in POFS activity and the need to present a credible plan to secure the necessary levels of funding, it was proposed that the 5 year plan profit target be adjusted downwards to more realistic levels - £85m PBIT rather than £160m,
 - (d) the Board discussed the proposed amended level for the Year 5 PBIT figure. It was pointed out that any significant downward adjustment would result in a proportionately negative effect on profit for the early years. Peter Corbett suggested that there were measures that could be taken to lessen the effect on cash requirements and ROCE such as reducing network cash, and adjusting the dividend policy with FRTS. After some discussion, the Board agreed that the £160m PBIT figure for Year 5 of the strategic plan would be adjusted to £85m;
 - (e) the Board agreed that the success of Banking and the Card Account launch would be further emphasised in the historical achievement section of the plan. Graham Halliday would provide Peter Corbett with the required words to create a page
- Action:**
Graham Halliday

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Peter Corbett on its own. An additional page would be created to distinguish between the gross and net sales numbers, to show new income streams on a comparable basis with existing ones, notwithstanding that the presented numbers represent the way in which the figures will flow into the accounts (ie: with a much higher 'cost of goods sold' impact)

POLB05/98 TRANSFORMATION PROGRAMME POLB(05)80

- (a) Peter Corbett provided an brief update on the Transformation Programme.

POLB05/99 SOLVENCY POLB(05)80

- (a) Peter Corbett reported that the key issues in relation to solvency continued to be to ensure:
 - (i) profit and cashflow were at least in line with budget;
 - (ii) the 'route map process' proceeded in line with the agreed timetable.
- (b) Post Office Ltd continued modestly to exceed its profit target and more clearly to exceed its cash target;
- (c) sustained solvency would be dependent on refinancing agreement being reached, as set out in the interim funding agreement signed at the previous year end;
- (d) discussions with the DTI and the Treasury were underway in conjunction with Royal Mail Group. The target was to complete due diligence by mid November, to agree in principle on a new financing package by early December, and to execute formal contracts before the end of the current financial year.
- (e) Notwithstanding that the original target date was September 30th, the Board agreed to the new timetable on the understanding that this was consistent with the Group funding discussions. On this basis the Board agreed that the company was a going concern for the purpose of the half year accounts.
- (f) The Board agreed that:
 - (i) having sought reassurance from the Shareholder Executive it expected the £300m of rural funding to receive state aid clearance and therefore become available;
 - (ii) it expected the company to meet its revenue and expenditure targets;
 - (iii) on the basis of a recent discussion with Government it expected a satisfactory new package to be put in place in accordance with the revised timetable which would provide the necessary funding to return the business to

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(iv) profitability and meet its funding and cash requirements.

(g) On this basis, and having regard also to the additional capital already provided to the company to meet its short term funding requirements through to March 2007, the Board agreed that the company was a going concern for the purpose of the half year accounts.

POLB05/100 ISA ROLL-OUT POLB(05)81

- (a) Peter Corbett provided the Board with an update concerning the financing of ISA. The Board noted that
- (b) The existing rollout plans were progressing satisfactorily;
- (c) work was currently underway with subpostmasters to constitute the range of products that would be offered. Prioritisation of the subpostmasters would follow;
- (d) two business cases were currently being prepared in relation to ISA. The first business case proposed an increase in investment of £400,000. This was to take into account the increase in property costs that had resulted from unexpected problems such as asbestos removal. The second business case concerned the addition of 21 offices to the roll-out and amounted to £384,000.
- (e) Graham Halliday suggested that the roll-out of ATMs had experienced similar property issues, and Peter Corbett confirmed that the activities would be co-ordinated where possible to save money;
- (f) The Board agreed that delegated authority would be provided to Peter Corbett and David Mills to finalise and authorise both business cases.

POLB05/101 RURAL STRATEGY UPDATE POLB(05)81b

- (a) David Miller presented a Rural Strategy Update paper to the Board. The Board noted that:
- (b) the paper outlined the broad approach that would be taken in the December report to Government covering 'new and innovative ways of providing Post Office services in rural areas', and explored the 'political presentation' that Government would need to take in order to agree network change;
- (c) the outreach system had been successfully piloted, and there had been few objections to the changes in the service levels that had resulted;

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- (d) a need existed to ensure that Government was properly briefed on the complex issues involved, well in advance of the Parliamentary statement in 5 month's time;
- (e) In addition to rural branches, Post Office Ltd also had some urban, urban deprived and Directly Managed branches which it managed at a loss. Additional funding would be sought from Government to cover these losses;
- (f) David Mills reported that Barry Gardiner had appeared to push this matter in the direction of DEFRA. Allan Leighton clarified that Mark Higson at the DTI was the only key contact concerning this issue, and the focus of influencing activity should remain clearly with the DTI;
- (g) the issue of rural strategy would feature on the next Royal Mail Holdings Board agenda;
- (h) the Board agreed that the paper provided a very good starting point, and that David Miller and Mike Granville would compose a letter to Mark Higson on behalf of Mike Hodgkinson, to outline what would be required to reduce the Social Network Payment requirement from £150m to £75m;

Action:
David Miller

POLB05/102 DIVERSITY STRATEGY POLB(05)82

- (a) Ian Anderson presented the Diversity Strategy paper to the Board. The Board agreed the paper, subject to a minor amendment suggested by Jonathan Evans on the final page.

POLB05/103 IR STRATEGY POLB(05)83

- (a) Ian Anderson provided a presentation on IR strategy in relation to cash centres. The Board noted the presentation, and in particular that:
- (b) external cash in transit work was high risk, provided no reward and was not part of Post Office Ltd's core activity;
- (c) CWU acceptance of change had been dependent on Cash Services putting financial incentives in place. The CWU had tended to drive an oppositional approach to management;
- (d) any industrial action at Cash In Transit sites had the potential to spill over to Royal Mail Group, and would need to be very carefully managed;
- (e) a programme of active engagement of employees would commence on 23rd September. This would be challenging given the quality of local management was patchy in some areas. The CWU would continue to be consulted, and any

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counter-proposals would be examined;

- (f) stretching targets had been set for measuring and improving leadership, direction, people communication and performance by quarter 2 of 2007. This would be achieved with a combination of increased dialogue, senior management visibility, a shift manager review and development programme, 'change champions', career counselling, recognition programme for change, flagship depots and a review of the communications channels;
- (g) Allan Leighton acknowledged that this would be difficult to manage and the Have Your Say results from the staff had been very mixed. Ric Francis underlined that the key to success in this area would be to successfully listen and engage with the staff, and this would remain the priority. Cash in transit activity within Post Office Ltd would never be profitable until day to day dynamic scheduling flexibility had been agreed;
- (h) the Board noted the presentation and agreed that the roll-out should commence in accordance to the planned timetable. The Board further agreed that Peter Corbett would prepare a financial analysis showing the loss/profitability on a marginal basis and after allocated costs.

Action:
Peter Corbett

POLB05/104 HORIZON PROPOSITION POLB(05)84

- (a) Ric Francis introduced Dave Smith and Ian O'Driscoll. A presentation was provided on Horizon Next Generation. The Board noted that:
- (b) the current proposal would almost halve the cost of Horizon and then reduce ongoing costs year on year. The original Fujitsu proposal had not met this objective, and the new proposal had been achieved after hard negotiation;
- (c) the original proposal would have resulted in a front-end spend of £150m, in addition to a fair amount of risk. The current proposal had removed £140m of cost by 'sweating' the existing assets within the operation for as long as possible. This would remove the need to have such a large initial capital outlay, but would still result in the rolling out to all 14,500 branches;
- (d) the proposal would still required a £50m front-end cost to pay for a shared data centre and a 'lights out' facility. However, it would not result in a penalty payment for breach of contract;
- (e) the current proposal resulted in an acceptable and achievable cost profile, and an agreement had been reached in principle with Fujitsu of new ways of working. The alternative would be to buy out the existing contract at a cost of £80m, disaggregate the services, and select an SI partner to manage the

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development and integration. This could deliver lower cost but would result in a significantly higher risk and a longer delivery time;

- (f) The other key features of the new proposal were:
 - (i) improved availability;
 - (ii) cost effective service management;
 - (iii) significant network savings;
 - (iv) SI Partnership;
 - (v) the duration of the contract would be until 2015.
- (g) David Burden had been briefed on the proposals;
- (h) the Board noted the progress that had been achieved, and agreed to the approach and to £6m investment that would be required to cover the period to full authorisation. Peter Corbett stated that this investment would be capitalised and impaired. The Board further agreed that a strategy paper would be written for noting at the Royal Mail Holdings Board in December 2005, and that the proposal would return for full authorisation to the Royal Mail Holdings Board in April 2006.

Action:
Ric Francis

POLB05/105 RISK AND COMPLIANCE COMMITTEE POLB(05)85

- (a) The Board agreed the Risk and Compliance Committee terms of reference.
- (b) The Board noted the Audit Recommendations, Risk and Compliance Committee Minutes and the Audit Report.

POLB05/106 ASSOCIATE COMPANY ITEMS FOR NOTING POLB(05)86

- (a) There were no further approved POFS minutes available for noting.
- (b) The FRTS Ltd minutes of 28th April 2005 and FRTS Holdings Ltd minutes of 28th April 2005 were noted.
- (c) The Board agreed that in the interests being provided with the most recent updates on POFS and FRTS activities, the minutes that had not been formally approved would be made available for noting at future Post Office Ltd Boards.

Action:
Neil Owen

FUNCTIONAL REPORTS

POLB05/107 FINANCE FUNCTIONAL REPORT POLB(05)87

- (a) The Board noted the report.
- (b) There were no further issues raised given Business Performance, Solvency and the Impact Programme had

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already been discussed in some detail.

POLB05/108 SALES & SERVICE REPORT POLB(05)88

- (a) The Board noted the report, and also noted that:
- (b) Sales Capability Training: Sales Capability managers were now in place in the Directly Managed network. Recruitment had begun to place 20 Financial Services Specialists into selected branches;
- (c) Service: Feedback from the Customer Satisfaction questionnaire showed an overall satisfaction level of 84% in respect of agency branches and a satisfaction level of 62% in respect of Directly Managed Branches. Key improvement opportunities have been identified and action plans developed;
- (d) Network Compliance and Conformance: A half-day training programme had taken place for the Sales Team to emphasise the need to 'Drive Compliant Sales';
- (e) Crown Strategy: 14 Directly Managed branches had been franchised year to date, and another 13 were either in consultation or about to go into consultation. The year-end forecast was in the 40-45 range. 18 'high value' sites had now been identified for sale, with a total target number of 24. The preferred option was to franchise off-site and to sell the freehold;
- (f) Restrictions: On the basis of a review of the new restrictions policy (deployed within the network 21st – 23rd September), the OFT have provisionally decided to close their case file on the ACS complaint;
- (g) Agents Pay Round 2005:
 - (i) agreement had been reached with the NFSP at the beginning of September. The consolidated increase would be 3.1%, although the headline rate was 3.4%. The latest projection from Finance confirmed a likely outturn of around the £525m for year end in accordance with original plan;
 - (ii) the new Share in Success for Subpostmasters had replaced the proposed bonus tier for this year (part of the original PRAG agreement) but the NFSP have stressed they would wish to open negotiations on this tier again should the Share in Success not continue in future years.

POLB05/109 MARKETING & DIRECT SALES POLB(05)89

- (a) The Board noted the report and in addition that:

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- (b) PayStation™: Negotiations continued with Barclays Bank;
- (c) Mails:
 - (i) further work has been undertaken to build a partnership relationship with Royal Mail, rather than the account management structure that currently existed. Additional resources had been deployed in the Rainbow programme to focus on growing the profit from joint mails products and to support packets strategy. This work could lead to an increase in Group profit but a decrease in POL income;
 - (ii) a special delivery campaign targeted at SME customers would shortly be deployed. Proposals to run a joint Christmas post campaign were rejected by Royal Mail Letters because the margins could not support the plan. This would be the first festive season without a consumer campaign, and risked possible adverse statements from Postwatch. These would be monitored but could impact on the 1st and 2nd class stamp mix.
- (d) HomePhone: Progress continued with around 250,000 customer signups since the January launch, of which 110,00 were now live and making calls. This was faster than any other new entrant to the market, but short of the plan for this year. A significant uplift would be required from the sales team to achieve target. This would be addressed through the use of field sales agents;
- (e) Other Product Development:
 - (i) Pre-Paid Debit Cards: Work on pre-paid debit cards continued with a travel funds card on schedule for pilot in the new year and roll out to hit the 2006 summer travel peak;
 - (ii) Gift Vouchers: Gift vouchers had been launched across the network in time for Christmas. Customers would be able to buy vouchers (paper for the majority, plastic for Debenhams) from any of over forty high street retailers from their local Post Office branch;
 - (iii) ID Cards: A decision had been taken by the Executive Committee not to bid for the first stage of the Government's ID card work. This would have required the establishment of a physical network of offices to facilitate interviews for new passport applicants. The terms around this tender were prescriptive and uncommercial. Further tenders were expected in the New Year.
 - (iv) Paystation™: Centrica, and Scottish Power had agreed to go live with the new Paystation™. There had been no progress with Transport for London.

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POLB05/110 BANKING & FINANCIAL SERVICES POLB(05)90

- (a) The Board noted the report and in addition that:
- (b) LINK: Post Office Ltd was now an active member of the OFT payments systems' Task Force, LINK Access Working Group, and LINK membership was being pursued for manned counter terminals. This group would report by the end of this year, and a key step towards this would be a working group meeting on 28th October when recommendations would be formulated. Feedback had indicated the banks and LINK were increasingly uneasy with our input and Post Office Ltd had recently been accused of abusing its position. The case for membership would still be heard, and the suggestion was (based on feedback from the banks) that if the OFT and Government wanted a deal to take place then most of the Banks should agree, although there may still be some notable dissent and potentially a legal challenge;

POLB05/111 OPERATIONS REPORT POLB(05)91

- (a) The Board noted the report. There were no further issues raised given the Horizon Next Generation project and the Cash In Transit IR strategy had already been discussed in detail.

POLB05/112 HUMAN RESOURCES REPORT POLB(05)92

- (a) The Board noted the report and in addition that:
- (b) Have Your Say: There had been slight improvement this month with the September 'I enjoy working here' score up 64% compared to 58% last year. The year to date score was 62% compared to 64% last year, but up from last month's 61%. Have your say remained a key area of focus for the rest of the year with monthly updates to the Executive Committee. Working parties which would focus on improvements had been set up in NSS and Retail Sales, which were the areas that required the most attention;
- (c) Headcount: Headcount reduction was ahead of plan at 298. Staff expenditure was £1.0m above budget, but plans were in place to correct this by year end. The focus continued to be on resolving transitionals which were currently running at 66.

POLB05/113 SEALINGS POLB(05)93

- (a) The Directors approved the affixing of the common seal of the company to the documents set out against item number 137/05 and 183/05 inclusive in the seal register.

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POLB05/114 RECOGNITION POLB(05)94

- (a) Gordon Steele presented Derek Rocholl to the Board. Derek Rocholl explained that he would be leaving the business after 17 years of service to pursue charitable interests. The Board expressed their appreciation for the excellent work Derek had undertaken as Category Manager, and wished him every success for the future.

POLB05/114 ANY OTHER BUSINESS

- (a) Jonathan Evans reported that the Royal Mail Holdings Board had delegated authority to the Post Office Ltd Board to approve investment cases up to the value of £20m, from its current value of £10m.

POLB05/115 CLOSE

- (a) There being no further business, the meeting was closed.