

1/19/3
IN STRICTEST CONFIDENCE

THE POST OFFICE

9 March 1999

~~Mr Stephen~~
Nigel Goss
Charles Langley
Tracey Churley and - for
file.

Mr Stephen Byers
Secretary of State for Trade & Industry
Department of Trade & Industry
1 Victoria Street
LONDON
SW1H 0ET

Dear Stephen,

I was very glad to have the opportunity to see you last Friday to exchange views on the latest approach to Horizon and progress with the White Paper. We talked about some of the key issues emerging in the White Paper where the Post Office had concerns and I promised to write to you about them.

They are as follows:

- (a) We would like to see a clear and unambiguous mechanism by which the regulator is required, in setting pricing and service objectives, to take into account financial targets set by Government. This is particularly important in respect of the proposed restructuring at 1 April 2002 of the Post Office's balance sheet. Although we have still to agree details of the scale of this restructuring, if there is no change in financial targets, this would require us to raise prices significantly. (Over £100m of income from interest is at risk.) But it is also important more generally in a situation where the Board is required to meet Government targets and has not got the freedom open to other regulated industries simply to cut dividends or perhaps to borrow.
- (b) The Post Office is pleased that Government has agreed that large scale investment cases, which are commercially robust, will be approved. But we do need a clear understanding, either in the White Paper or in a side letter, of the criteria by which "commercially robust" will be evaluated. Larger scale acquisitions require a huge amount of resource and trust between the two parties involved well before final authority is given. It is therefore crucial to have some clear parameters set so we can enter into discussions with confidence.

In this connection I drew your attention to the vote of The Post Office Board which is now constituted with able experienced independent non-executive directors. Procedures are in place for robust testing of any proposals put forward by the executive.

ANNEX B

Mr Bilton

Handed over by P8
This evening. Letters
discuss?
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GRO

Mr Baker CGBS

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- (c) The Post Office remains concerned about the potential conflict between liberalisation measures originating from Europe and from the UK Government, particularly in respect of our ability to finance the Universal Service Obligation at a uniform price. The logical way forward might be to await clarification from Europe before making any changes. But if you do feel a need to make an earlier decision, a formula of an early announcement with implementation from 1 April 2000 would leave time for European intentions to become clearer. There is, however, an important need to ensure that if such an announcement limited the monopoly to 50p and items weighing less than 150 grams, then the 50p element is maintained in real terms until further liberalisation is decided, based on the direction emerging from Europe. This could be done by giving an explicit duty to the regulator to review the price element in the light of RPI.
- (d) The Post Office would not want to be in a position at each year-end where it was forced to spend or lose its £75m annual facility for smaller investments, as this would give rise to some uncommercial behaviours. There will also be occasions when it would be commercially sensible to bring forward an element of next year's £75m. We therefore suggest that, in line with the current arrangements for the EFL, an up to £30m roll forward-or-back facility is agreed.

We also discussed the difficulty of publishing the White Paper against the continued uncertainty about the Horizon project. I think we are all agreed that, without an automated network, a nation-wide network of post offices as currently envisaged would be unlikely to be sustainable. Clarity over Horizon thus becomes the key to this whole area.

If Government does decide to delay the White Paper until May then the Post Office would understand this. However, it would very important in such a situation for investments to be operative (albeit informally) from 1 April 1999. The pace of acquisitions and developments in our markets is still increasing and without access immediately to the new arrangements the Post Office and UK would be severely damaged.

We will continue to keep in close touch with Ian McCartney on all Post Office issues but I believe it important that we meet on the key policy issues from time-to-time. I look forward to seeing you at Gatwick on 26 April and hope you will be able to meet the full Board at some point later in the year.

Kind regards

Yours sincerely

GRO

Dr N C BAIN
Chairman