

RESTRICTED – POLICY AND COMMERCIAL

To Secretary of State
From Post Office Network Team
Date 30 September 2011

Meeting with Alice Perkins, Chair - Post Office Ltd 14:30-15:30 Monday 3 October 2011

Purpose

To meet Alice Perkins, the newly appointed Chair of Post Office Ltd (POL); to discuss the Government's strategic goals; and to explore her initial impressions of the company.

Attendees

Alice Perkins (POL), Will Gibson (ShEx), Susannah Storey (ShEx)

Your objectives

- To emphasise to Alice the priority with which the Department views the Post Office.
- To gain an initial impression from Alice, of how she views the challenges and opportunities of the new role.
- To make clear (in the context of the Postal Services Act) the importance of there being an orderly separation of POL from Royal Mail; and the role of a strong, independent POL Board in achieving that; and to understand the progress Alice is making in establishing that Board.
- To stress the importance that POL reduces its long-term reliance on subsidy, through the successful implementation of its commercial strategy.

If raised:

- Given the £1.34 billion investment Government is making into POL over the spending review period, to stress the important that ShEx has a presence on the POL Board once POL is operationally separate from Royal Mail, expected to be from March 2012. (This is consistent with the governance for many other ShEx businesses.)

Alice Perkins' objectives

- Alice formally became Chair on 22 September and is holding bilateral meetings with the BIS Senior team. She will be looking to gain a clear understanding of the Department's priorities (Alice met Martin Donnelly on 27 September, and will be meeting Edward Davey later in October).

RESTRICTED – POLICY AND COMMERCIAL

AGENDA FOR MEETING – ISSUES TO RAISE AND POINTS TO MAKE

	Points to draw from:
Separation and establishment of the Board	<ul style="list-style-type: none"> Separation will allow POL to focus on the challenges and opportunities that it faces. But POL and Royal Mail will remain reliant on one another. To ensure the right commercial contracts are in place, POL needs an independent and robust Board to represent its interests in the negotiations. I have approved the appointment of a Senior Independent Director, Neil McCausland. I'm keen to hear more about your plans to develop the Board, and ensure the right balance of skills and expertise is present. [If raised] Given Government's ongoing 100% ownership of POL, and in light of the £1.34 billion investment, it is important that the Shareholder Executive joins the Board. [If raised] This is consistent with the governance arrangements for other businesses in which the Government has made a significant investment, and is something that I must insist upon.
Commercial Strategy: General	<ul style="list-style-type: none"> The Commercial Strategy was instrumental in securing such a large and generous SR settlement. Its successful implementation is a key Ministerial priority and a necessary precondition to future mutualisation. Implementing this Commercial Strategy will be critical in making the business more sustainable and reducing its long-term reliance on subsidy, and will require strong Board support and oversight.
Commercial Strategy: Government Services	<ul style="list-style-type: none"> Government services form a key part of the Commercial Strategy. It is fundamentally important that POL is as commercial as possible to win Government contracts. The DWP Green Giro (SMOTs) contract experience shows that Government cannot simply award contracts to POL. The importance of new Government services revenues to the delivery of the strategy means that it is critical that POL's team is appropriately resourced and staffed.
Commercial Strategy: Network Transformation	<ul style="list-style-type: none"> The next year is particularly important for the network as new operating models are developed and implemented. By 2015, over half the network will have moved to new operating models. POL has a good track record of successfully conducting large scale network changes, but we must not be complacent
Mutualisation	<ul style="list-style-type: none"> We have now begun our consultation on developing a mutual ownership model for POL. We will continue actively engaging with you and the POL team as the policy develops.

RESTRICTED – POLICY AND COMMERCIAL

Background

Post Office Ltd (POL) is a subsidiary of Royal Mail Group Ltd, and although the company has executive directors of its own, it has, historically, been subject to oversight by the full Royal Mail Holdings plc Board. The passage of the Postal Services Act 2011 will separate POL from Royal Mail, and preparations are being made for new, separate and suitably robust governance arrangements for a separated POL.

Alice's appointment, approved by Ministers in July, was the first step in establishing those governance arrangements. She formally took office on 22 September. Alice met Edward Davey (with officials) prior to her appointment but, and met Martin Donnelly last week on 27 September. Alice will need to demonstrate clear and strong leadership to ensure that the interests of POL, often perceived to date as the junior partner to Royal Mail, are best reflected in the separation process. This involves negotiating key contracts with Royal Mail around shared services and the distribution by POL of Royal Mail products (historically c40% of POL revenues). Separation negotiations are expected to be completed in the next few months, with the businesses becoming operationally separate when the pension deficit solution is implemented (expected March 2012).

Alice's role will also involve building an independent Board for the company; supporting POL executives in the delivery of the company's strategy to reduce its long-term reliance on Government subsidy; and positioning the company for a possible future move to a mutual structure. To achieve this, Alice has stated her intention to conduct a review of POL's Board to ensure that there is an appropriate mix of skills and experience to meet the challenges that the business faces in transforming its network; implementing its commercial strategy: developing new services and winning contracts; and eliminating Crown losses. You should be aware that we have been clear to Alice that it is your and Edward Davey's view that the Shareholder Executive should be part of that board (consistent with the arrangements on the majority of their other portfolio companies) after separation next March. We understand from her discussion with Martin Donnelly last week that Alice has some reservations about this but we think it is very important to hold the line given the level of financial commitment the Government is making to the Post Office and the priority with which it is viewed. (Further background on this issue is set out in **Annex A**).

Over the course of the spending review period, POL's strategy encompasses the introduction of new network models to 6,000 post offices (c4,000 "Main" post offices and c2,000 "Post Office Locals"). These will have longer opening hours, greater automation and therefore address queuing issues. They will also introduce a greater level of variability to POL's cost base. Over the same period, POL also proposes to eliminate the losses made by its 373 Crown

RESTRICTED – POLICY AND COMMERCIAL

post offices, which currently lose c£55m pa. This will involve both cost reduction (principally staff costs) and growing revenues. The principal target for revenue growth is Government services, where POL's ambition is to become the "Front Office for Government" as more and more local and national Government services move online and see their front office functions outsourced. However, POL has faced difficulties to date in winning new Government work, for example losing out to a rival bidder in relation to DWP's "SMOTs" contract for the payment of benefit cheques. The outcome of a current tender for UKBA work is expected imminently.

Preparing the company for possible mutualisation (assuming the successful implementation of the commercial strategy) will also be a key role. We have now published our consultation document on developing a mutual ownership model for POL (on 19 September) and are grateful to Alice and the wider POL team for their input into this. We will continue engaging with Alice and the team as the policy is developed over the coming months.

CC list Davey MPST; Perm Sec MPST; SPAD MPST; Susannah Storey; ShEx POL team; Josh Coe.

RESTRICTED – POLICY AND COMMERCIAL

Annex A – background on Shareholder Executive Board seats and implications for Post Office

- ShEx practice is to take Board seats in its portfolio assets unless there are compelling reasons not to.
- We sit on the Boards of the majority of our portfolio businesses. For example, ShEx officials sit on the Boards of Eurostar, Urenco, The Royal Mint, Scottish Water, Ordnance Survey, the Met Office and the Land Registry, among others.
- This is also standard practice in other areas where shareholders own a significant proportion of a business (for example private equity financed businesses).
- The decision for ShEx to take a Board seat (originally made by you and Edward this spring) was confirmed by Edward Davey this month.
- Alice is aware of our intention, but in her meeting with Martin Donnelly indicated some concerns about this.
- Alice's concerns were relayed to Edward Davey after that meeting and Edward has again reiterated his strong feeling that ShEx should take a Board seat.
- [Stephen Lovegrove is seeking to speak to Alice in advance of her meeting with you, to pass on Edward's views. But it is possible that Alice may raise her concerns with you.]

So that you are aware, Alice raised three concerns about ShEx Board membership in her meeting with Martin:

1. Her first concern was that ShEx joining the Board was inconsistent with the vision for a mutual where Government's relationship with POL is purely contractual.

ShEx position: We do not agree with that position because between now and mutualisation POL must successfully implement its commercial strategy, which is something in which the Government has an intrinsic interest and a ShEx Board seat is therefore important for the reasons set out above.

2. Her second concern was that ShEx joining the Board would in some way prevent Government insulation from the impact of operational decisions.

ShEx position: In reality, the impacts of many operational issues in POL already lead to pressure on the Department, at both official and Ministerial level. We do not see that a ShEx Board member would

RESTRICTED – POLICY AND COMMERCIAL

materially change the position.

3. Her third concern was that one Board member had indicated they would be reluctant to serve on a Board where a ShEx appointee was also a director.

ShEx position: This is concerning in that if a POL non-executive is reluctant to serve on a Board with a representative of the shareholder who has approved his appointment, then that does raise questions of why they are serving on the Board.

RESTRICTED – POLICY AND COMMERCIAL

**Annex B – Key commitments contained in the Policy Statement
“Securing the Post Office Network in the Digital Age” (Nov. 2010)**

- We recognise that the Post Office is more than a commercial entity and serves a distinct social purpose.
- We will ensure that post offices remain a valuable social and economic asset for our communities and businesses.
- There will be no programme of post office closures under this Government.
- The Post Office is not for sale.
- We will provide £1.34 billion for the Post Office to modernise the network and to safeguard its future, making it a stronger partner for Royal Mail.
- We want to see the Post Office become a genuine Front Office for Government at both the national and local level.
- We will support the expansion of accessible and affordable personal financial services available through the Post Office.
- We will support greater involvement of local authorities in planning and delivering local post office provision.
- We will create the opportunity for a mutually owned Post Office.
- The breakdown of payments to the Post Office will be as follows:
 - £180 million in the financial year 2011-12 (as we have already committed)
 - £410 million in the financial year 2012-13
 - £415 million in the financial year 2013-14
 - £330 million in the financial year 2014-15