

Royal Mail – Strictly Confidential

RMH(04)4th
RMH04/67 - 87

ROYAL MAIL HOLDINGS plc
(Company no. 4074919)

Minutes of the meeting of the Board of Directors
held at 148 Old Street, London, on 6th April 2004

Present:

Allan Leighton	Chairman
Marisa Cassoni	Chief Financial Officer
Adam Crozier	Chief Executive, Royal Mail Group
David Fish	Non Executive Director
Richard Handover	Non Executive Director
Sir Mike Hodgkinson	Non Executive Director
Tony McCarthy	Group Director, People and Organisational Development
David Mills	Chief Executive, Post Office Ltd
John Neill	Non Executive Director
Elmar Toime	Executive Deputy Chairman
Bob Wigley	Non Executive Director

In attendance:

David Burden	Chief Information Officer
Jonathan Evans	Company Secretary

Also present:

Richard Barker	Post Office Limited, for RMH04/76
Michael Mire	McKinsey & Co, for RMH04/77
Martin Gafsen	Group Investment Director, for RMH04/76-77

RMH04/67

MINUTES OF PREVIOUS MEETING RMH(04)3RD

The minutes of the meeting held on 9 March 2004 were approved and signed.

RMH04/68

MATTERS ARISING – RMH(04)70

The Board noted the status report.

RMH04/69

OTHER MINUTES – RMH(04)66-69 and 84

- (a) The Board noted the minutes of the meetings of:
- the Pensions Sub-Committee of 9 February 2004
 - the Post Office Ltd Board of 17 February 2004
 - the GLS Supervisory Board of 27 November 2003
 - the Audit and Risk Committee of 11 November 2003 and 18 March 2004.
- (b) in respect of the Post Office Ltd Board minutes, David Mills undertook to clarify the reference at POB04/07(a)(ii) about the reported potential loss from the Ordinary Account.

ACTION
David Mills

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RMH04/70

CHAIRMAN'S BUSINESS

- (a) The Chairman reported that he had been in correspondence with Nigel Stapleton, the Chairman of Postcomm. By July Postcomm had to decide the speed at which it proposed to open the postal market to further competition, and to have completed some preliminary steps in determining the shape of the future price control. Allan Leighton had therefore invited Mr Stapleton and a few of his fellow commissioners to attend the May Board meeting to discuss these matters before any firm proposals were made;
- (b) the Secretary of State had responded on 31 March to the Chairman's letter about the shareholder relationship discussed at the previous board meeting. The Secretary of State had approved the relationship document and had sanctioned the requested increases in pay for certain directors; however she was continuing to withhold agreement to pending Board appointments until actions were in hand to recruit a new non-executive director from the trade union sector. The Board continued to have reservations about the need for such an appointment, and agreed that the next steps should be for the Chairman of the Nomination Committee to write to the Secretary of State expressing the Board's views, in advance of which the Chairman would attempt to have an informal discussion with the Secretary of State.

ACTION
Richard Handover
Allan Leighton

RMH04/71

REPORTS FROM CHAIRS OF BOARD COMMITTEES

- (a) Remuneration Committee: David Fish reported that the Committee had met the previous day and had discussed:
- results from a survey conducted by Mercers into remuneration levels for executive directors, in preparation for the July review
 - outline proposals for extending the arrangements for long-term incentive plans and the *Share in Success* scheme
 - proposals for the annual bonus scheme for 2004/05, on which the Committee had given its views to executive directors for further consideration
 - proposals for the introduction of salary sacrifice arrangements in connection with employee pension contributions;
- (b) Audit and Risk Committee: Bob Wigley reported that the Committee had met in March, when the main items discussed had been proposals for reviewing the Committee's terms of reference and way of working to ensure continuing compliance with the Combined Code and best practice; preparations for the production of the annual accounts; whistleblowing procedures; the level of internal audit resource, and reports from the Director of Internal Audit on the Company's control environment and state of compliance. The Committee had decided to hold in depth reviews with management representatives on internal audit reports which had revealed a

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state of either no or limited assurance: the first of these meetings had been held earlier that day, when the Committee had had useful discussions with the heads of operations about the implementation of the *Single Daily Delivery* programme, and with the Director of People and Organisational Services about a recent serious payroll fraud, and with the Group Finance Director and Company Secretary about the PAYE audit;

- (c) Corporate Social Responsibility Governance Committee: Sir Mike Hodgkinson reported that the Committee was currently giving priority to safety issues as there continued to be a number of areas where step change improvement in safety performance was needed.

RMH04/72

EXECUTIVE DEPUTY CHAIRMAN'S REPORT – RMH(04)71

The Board noted Elmar Toime's report.

RMH04/73

EXECUTIVE REPORTS

- (a) Oxford industrial action: Adam Crozier updated the Board on the recent recurrence of unofficial industrial action at Oxford mail centre, the fifth incident in five months. The dispute had been triggered by accusations of bullying in the mail centre: however disagreement had developed further over how, on resumption of work, management proposed to deal with people who had taken unofficial action. It was important to ensure that employees could not simply take unofficial action, which was unlawful, without there being consequences for them – particularly in a location with such a poor record of unofficial action. Discussions were taking place with the CWU at national level in an attempt to resolve the dispute, but there was a real risk that the action could spread across the country, although attempts were being made, successfully so far, to constrain this;
- (b) Parcelforce Worldwide: the PFWW executive meetings were being reconstituted as formal Board meetings, with Marisa Cassoni joining the Board and Adam Crozier taking the chair. Rico Back would also join the meetings on an occasional basis. Work was taking place on analysing the PFWW business model to ensure it continued to be a sustainable commercial proposition. In the meantime the PFWW management was focussed on improving the current model: pressure was continuing to be brought to bear on costs, and an announcement had been made to shed a further 1200 jobs. There remained a number of union restrictions to remove, in particular the constraint on moving to higher levels of owner-drivers, and these were being tackled;
- (c) Single daily delivery: Adam Crozier updated the Board on the latest position with the implementation of SDD revisions. 970 delivery offices had deployed their revisions, and the rest were due to be implemented within the following 1-2 months. Within

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this remainder was a potential hard core of offices which could give rise to industrial relations problems, and these were being carefully managed on an individual basis;

- (d) Headcount reduction: Adam Crozier informed the Board that the business was on track to reduce headcount numbers by some 9-10,000 by around the end of April. The number of surplus staff was growing, and increasing pressure was being exerted to encourage more staff to leave on the existing voluntary redundancy terms. The position was being monitored carefully – the business could not afford to carry large numbers of surplus people, while it was equally aware of the desirability of avoiding the need to recourse to compulsory redundancies.

RMH04/74

GROUP FINANCE DIRECTOR'S REPORT

- (a) 2003/04 performance: the Board noted Marisa Cassoni's presentation, based on the flash financial results for period 12. These showed that for the period, profit from operations was £34.1m, which was £28.3m and £41.8m adverse to budget and prior year respectively. For the full year, profit from operations was £220m, £45m and £293m favourable to budget and prior year respectively. Expenditure had continued to run over budget, predominantly as a result of headcount being above plan levels. This overspend had been compensated for by revenue being ahead of budget;
- (b) as at period 11, 13 of the 15 licence service targets had been failed for the year. It was still mathematically possible for the remaining two to be achieved, but unlikely.
- (c) 2004/05 budget review: the Board noted the papers detailing the proposed budget for 2004/05, and Marisa Cassoni's presentation. The Board noted further in discussion:
- (d) the budget proposed a profit from operations of £400m which, after the costs of the *Share in Success* scheme, would result in a profit of £257m – the target for the third year of the Interim Strategic Plan (ISP) presented to Government. The budget contained net risks of £196m in business units, with £82m of de-risking factors held centrally. The biggest area of risk stemmed from the challenge to continue reducing headcount by substantial numbers;

after discussion, the Board:

- (e) noted the over-performance in both profit from operations and trading cash compared with the ISP and financing packages;
- (f) noted that the budget met all covenants under the financing agreements;
- (g) noted that results by business unit would change to reflect re-organisations, changes in inter-business charges, and the

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allocation of costs from the *Share in Success* and other expenses;

- (h) noted that the Group results would be impacted by final taxation projections;
- (i) approved the Group budget for 2004/05 as presented;
- (j) authorised submission of the budget to the shareholder;
- (k) agreed that the Board would need to carefully monitor the risks and opportunities each month.

RMH04/75**TRANSPORT REVIEW – RMH(04)73**

- (a) The Board welcomed Paul Bateson and noted the paper and its conclusions. In discussion the Board noted further:
- (b) in Paul Bateson's view, the main reason for the programme failing to deliver its financial and quality targets stemmed from the lack of integration and team-working between the Logistics and RM Letters units, which resulted in network specifications which were unachievable and, until recently, ineffective implementation. The programme had been run centrally, and there had been insufficient involvement of operational managers;
- (c) improving quality was now a priority. The units were now working well together to solve particular design problems in the new network as quickly as possible, although it was expected to take until the Autumn for the current implementation problems to be sorted out. Paul Bateson informed the Board that the new network design would be capable of providing an acceptable level of quality of service, although some advancement of collection times in some areas may be necessary. The possible use of rail services to support quality performance at peak times was also being considered, and proposals would come before the Board in June;
- (d) in some directors' view, the paper insufficiently seriously addressed the substantial failings of the programme. While the Board was reassured to hear of the remedial action now being taken, it was of considerable concern that the programme, which had been reported on regularly to the Board, had experienced such a marked downturn in benefits in a short time. It was important that lessons be learned, and the Board informed each month of actions being taken and progress made.

ACTION
Adam Crozier

RMH04/76**NETWORK REINVENTION – RMH(04)74**

- (a) The Board noted David Mills' paper, which updated the Board on changes to the Network Reinvention project and business case in the light of the intervention by the DTI following their

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concerns about the build-up of public pressure about the programme;

ACTION
Sir Mike
Hodgkinson

- (b) the Board noted that the revised business case produced a £17.1m worsening in the benefits from the programme in 2003/04, with an £8.8m worsening in 2004/05. As this was in large part the direct result of DTI's involvement, resulting in the programme being conducted at a slower pace, the Board requested Sir Mike Hodgkinson to write to DTI asking for this impact to be reflected in POL's, and the Group's, financial targets;
- (c) after discussion the Board noted:
- the revised completion date of March 2005;
 - the reduction in the closure number from 3000 to 2400 branches;
 - an increase in programme costs of £19.4m to £48.6m;
 - an increase in steady state net annual benefits of £11.8m to £37.4m from 2007/08 onwards.

RMH04/77

STRATEGIC OPTIONS UPDATE

The Board was updated on the status of the analysis being made of possible future strategic options for the business.

RMH04/78

“A NEW BEGINNING” – RMH(04)75

The Board noted the latest version of the Company's proposed new vision and values statement. Any director with comments on the draft would supply them direct to Adam Crozier.

RMH04/79

ROYAL MAIL'S COMPETITORS: AN OVERVIEW OF HAYS – RMH(04)76

The Board noted the paper.

RMH04/80

ACCESS TO ROYAL MAIL'S POSTAL FACILITIES – RMH(04)77

The Board noted the paper. After discussion the Board:

- (a) confirmed that access agreements should be entered into with DPWN and TPG;
- (b) confirmed that further access agreements that were not materially different may be entered into with further approval of the Board;
- (c) noted the strategic options which were being scoped on upstream competition.

RMH04/81

MERGERS AND ACQUISITIONS REPORT – RMH(04)78

The Board noted the report.

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RMH04/82

GROUP TREASURY REPORT – RMH(04)79

The Board noted the report.

RMH04/83

SUMMARY OF INVESTMENTS PROJECTS – RMH(04)80

The Board noted the summary.

RMH04/84

REGULATION REPORT – RMH(04)81

The Board noted the report. The Board requested a paper at a future meeting to explain the background to the CCRAT issue which had caused difficulties with Postcomm. The Board wished to understand the actions taken, and the lessons learned.

ACTION
Marisa Cassoni

RMH04/85

EFFECTIVENESS OF CREDIT CONTROL – RMH(04)82

The Board noted the paper.

RMH04/86

COMPANY SECRETARY'S REPORT – RMH(04)83

The Board noted the report.

RMH04/87

OTHER BUSINESS

John Neill raised the question of the need for the external auditors to bring to the Board's attention any instances of fraud discovered in the course of their activities. Marisa Cassoni reported that Ernst and Young were alert to the need to do this, and any instances would be reported to management and the audit and risk committee.

CLOSE

In the absence of any further business, the Chairman closed the meeting.

The next meeting was scheduled for 4 May 2004, at 148 Old St, London.