

**Royal Mail – Strictly Confidential**

**RMH(04)9<sup>th</sup>  
RMH04/166 - 188**

**DRAFT**

**ROYAL MAIL HOLDINGS plc**  
(Company no. 4074919)

**Minutes of the meeting of the Board of Directors  
held at 148 Old Street, London, on 5 October 2004**

**Present:**

Allan Leighton	Chairman
David Burden	Group Chief Information Officer
Marisa Cassoni	Group Finance Director
Adam Crozier	Chief Executive
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
Bob Wigley	Non Executive Director

**Apologies:**

Elmar Toime	Executive Deputy Chairman
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**In attendance:**

Jonathan Evans	Company Secretary
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**Also present:**

Gerry Degaute	Chief Executive, Royal Mail Pensions Trustees Ltd for RMH04/177
Alex Smith	Strategy Director, Royal Mail Letters, for RMH04/178
Alan Barrie	Operations Support Director, Royal Mail Letters, for RMH04/178
Frank Schinella	Financial Management and Control Director, for RMH04/178
Michael Mire	McKinsey & Co, for RMH04/178

**RMH04/166**

**MINUTES OF PREVIOUS MEETING RMH(04)8<sup>TH</sup>**

- (a) The minutes of the meeting held on 4 August 2004 were approved, subject to a minor amendment to RMH04/160, clarifying that in the discussion on pensions strategy, the Board asked for any proposed changes in actuarial reduction factors to be explained when the matter returned to the Board in due course.

**RMH04/167**

**MATTERS ARISING – RMH(04)151**

- (a) The Board noted the status report.

**RMH04/168**

**OTHER MINUTES – RMH(04)149 and 150**

- (a) The Board noted the minutes of the meetings of:
- the Post Office Ltd Board on 16 June 2004
  - the GLS Supervisory Board on 23 June 2004.

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RMH04/169

**CHAIRMAN'S BUSINESS**

- (a) Non-Executive Director: the Chairman reported that following a selection process conducted under the rules of the Office of the Commissioner for Public Appointments, which had also benefited from the close involvement of members of the Nomination Committee, the Secretary of State had given her consent for the appointment to the Board of Baroness Margaret Prosser as a non-executive director. The Board formally approved the appointment, which would take effect on 1 November 2004;
- (b) Elmar Toime: the Chairman reported that Elmar Toime would be leaving the Company within the following few weeks to pursue a career as an international postal consultant. Departure terms were being agreed by the Remuneration Committee within the terms of his contract. Adam Crozier would take over responsibility for Parcelforce and Royal Mail international affairs, while GLS would report directly to Allan Leighton.

RMH04/170

**REPORTS FROM CHAIRS OF BOARD COMMITTEES**

- (a) Nomination Committee: Richard Handover reported that progress was being made in filling the post of Chairman of Royal Mail Pensions Trustees Ltd, with two strong candidates having final interviews. The calibre of the candidates was such that it may be necessary to pay a higher fee than had been anticipated, but the importance of the Chairman role at the current time would clearly warrant this;
- (b) Remuneration Committee: David Fish reported that the remuneration issues for GLS executives which were raised during the Board's visit to GLS in July had been resolved. The annual bonus scheme for executive directors was still a subject of continuing discussion with the DTI and HM Treasury. Shareholder representatives were so far showing support for the proposals being developed for the future LTIP and *Share in Success* schemes, although at this stage Government had not been asked to make any decisions;
- (c) Audit and Risk Committee: Bob Wigley reported that two audit committee meetings had been held since the last full Board. The draft minutes of the first were handed out to the Board, and the second had taken place the preceding evening. Bob Wigley took the Board through the minutes of the first meeting drawing the Board's attention to:
- the focus on overdue internal audit recommendations
  - the changes to the committee's terms of reference and processes arising from the self-assessment exercise recently undertaken by the committee
  - the report of the external auditors addressed to the Chairman on 2003-4 and its conclusions
  - the delegated authorities paper presented to the committee and the changes requested to it - now incorporated in a revised paper considered at the previous evening's meeting

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- and on the Board's agenda
  - the paper on the need for a new group investment appraisal and monitoring process presented by Martin Gafsen. The original paper had shortcomings, and the revised paper presented to the previous evening's meeting had addressed the committee's concerns and was on the agenda for the Board to approve
  - the committee's request that the Company Secretary reports to the Board monthly an ongoing tracker of regulatory investigations and potential investigations and other similar issues
  - the proposed relaunch of substantially enhanced whistleblowing procedures and the ongoing reporting to the committee of whistleblowing activity;
- (d) Bob Wigley also reported on the previous evening's meeting to review internal audit reports with limited or no assurance. He reported in detail on section 4.2 of Internal Audit's report on potential non-compliance with the licence. He updated the Board on the presentation made by management on this topic and on the programme of work now proposed by management to achieve two principal objectives - to put in place a sufficiently robust compliance function going forward to give the Board adequate assurance about licence compliance and secondly to scope and deal with legacy non-compliance issues. Jonathan Evans would work with Slaughter and May on a rapid and comprehensive programme to achieve these two objectives with the aim of reporting to the next audit committee meeting. Management would also consider carefully how to communicate the extent of past non-compliance to Postcomm and proposed changes to procedures. This was to be progressed as rapidly as possible with an update being presented to the next Board. Adam Crozier was to consider whether sufficient resource was being dedicated to scoping legacy non-compliance issues and in particular non-standard prices given the potential revenue loss, which management could not at this stage precisely quantify, and report back to the next Board. Bob Wigley went on to report on the internal audit report on purchasing procedures and management's presentation to deal with issues identified. Jonathan Evans was to consider further the issue of how and when to report any non-compliance with public procurement regulations to the DTI and provide an update at the next meeting of the committee;
- (e) John Neill added that the committee had also discussed the audits on the state of compliance with standard traffic forecasting measures in mail centres, and on progress with the introduction of Single Daily Delivery. The latter report had caused the committee considerable concern, as it gave only limited assurance that the savings being made in delivery offices would be sustainable, while the pay increases implemented were permanent. Operational management present at the committee had given assurances that additional resource was not being introduced to protect quality of service at the expense of failing



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financial targets. Furthermore where offices were failing targets, appropriately robust corrective action was being taken on an office-by-office basis. In many instances this was creating some industrial unrest: but the committee was assured that there was no question of any re-instatement of restrictive practices in order to secure agreement. The committee had taken some comfort from management's responses, but progress with SDD, and in particular the sustainability of the targets, would continue to be monitored closely;

- (f) Corporate Social Responsibility Governance Committee: Sir Mike Hodgkinson reported that the committee was continuing to make progress. A memorandum of understanding had recently been agreed between the committee and Internal Audit which set out their respective roles in safety audits.

RMH04/171

**EXECUTIVE DIRECTORS' REPORTS**

- (a) The Board noted the reports from the executive directors, and noted in particular:
- (b) Post Office Ltd: there had been an 80:20 vote in favour of the subpostmasters' pay deal at a special conference of the Federation. This was a very pleasing result as it would result in a much more sales-incentivising pay system for subpostmasters;

**ACTION**  
**David Mills**

- (c) David Fish commented that now that network re-invention was nearing completion and the attention was turning to the directly-managed network, more attention should be given to investment in branches and that the topic should have its profile raised. David Mills undertook to consider this further;

**ACTION**  
**Jonathan Evans**

- (d) Technology, Services and Innovation: David Burden reported that HWDC was now operational. The Board agreed to hold a future meeting at the unit. In response to questions from the Board, David Burden explained that the YANTRA systems in the Logistics unit had been unsuccessful, costing some £2million. Discussions were underway with the supplier to determine the best way forward;
- (e) People and Organisational Development: Bob Wigley queried why Tom Melvin, Operations Director in RM Letters, was reported as setting the pay rates for agency staff. Tony McCarthy explained that agency hiring rates were seen as an operational cost, for which Tom Melvin had budget authority;
- (f) Chief Executive's report: Adam Crozier updated the Board on the following issues:
- (g) Postcomm: Martin Stanley had now left Postcomm to take up his new role as Chief Executive of the Competition Commission. Final interviews were taking place with the aim of appointing a new Postcomm Chief Executive in the near future. The investigation into whether Royal Mail had used all reasonable endeavours in attempting to meet Quality of Service targets in



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2003/04 had gathered all of its evidence, and the Commissioners were now trying to come to a decision on the results. Informal talks were continuing with Postcomm and the Shareholder Executive about the next price control, and the hurdles which would need to be cleared before its introduction. This subject would be a key item on the agenda of the forthcoming meeting between the Board and the Commissioners;

- (h) Bulk compensation scheme: Postwatch was claiming that a large, albeit unquantified, number of customers had complained to them about Royal Mail's stance on the compensation scheme. The Company was adhering to the position that it was carrying out equitably the terms of the compensation scheme agreed with Postcomm;
- (i) Operational issues: Single Daily Delivery had been deployed in 94.8% of delivery offices and 95.8% of sub-offices, with 88.1% of staff now in a position to earn the additional £26.28. A relatively small number of offices were having difficulty in maintaining target savings after the qualifying period for the bonus payment – causing some industrial unrest - and these were being tackled on an office-by-office basis. Recognition was rightly having to be given in some cases to increases in traffic volume since the target baseline date of June 2003. As had been confirmed to the Audit Committee the previous evening, operational management was standing firm in not allowing any re-introduction of restrictive practices in order to solve any individual disputes;
- (j) Recruitment: progress was continuing to be made in improving recruitment processes. In addition the number of staff on temporary contracts had been reduced from 23,000 at the beginning of 2004 to some 5,000 currently;
- (k) Quality of Service: the level of operational failures continued to be under control, although there had been an increase immediately after the end of the summer period as volumes had risen. The period 6 result was 93.1% for 1<sup>st</sup> class, and this was expected to decrease to around 91.5% in period 7 as autumn volumes grew. Adam Crozier reminded the Board that while the recent press criticism had tended to imply that service target failures were a recent phenomenon, Royal Mail had in fact failed its 92.5% 1<sup>st</sup> class target for the last five years at least. David Fish asked whether the operational pipeline was sufficiently robust to cope with the increasing volumes in the rest of 2004. Adam Crozier replied that the prime focus of operational managers was to ensure this: particular attention was being paid to the poorest performing mail centres, and to having contingency plans to protect against adverse weather conditions;
- (l) Customer complaints: Customer complaints were showing a 3% year-on-year increase, with a big increase in delivery complaints compensated for by a reduction in complaints about loss;
- (m) The Board agreed that future executive reports should include more on safety performance, and also that there would be a

**ACTION  
Executive**

**Royal Mail – Strictly Confidential****directors**

written CEO report each month.

**RMH04/172****FINANCE DIRECTOR'S REPORT**

- (a) The Board noted Marisa Cassoni's presentation, the key points from which were:
- (b) period 6 profit from operations was £79m, some £40m favourable to budget. This good performance had been achieved despite people costs being £27m above budget, and accelerating;
- (c) headcount up to period 5 was 1362 adverse to budget, and while full-time equivalent people numbers had reduced, they were adverse to budget by 5091;
- (d) all 15 licence targets were failed as at period 5, but there were improvements in a number of products, and 1<sup>st</sup> class stamped and metered was just below target at 92.4%;
- (e) on the "Great Place to Work" measures, 59% of people said they enjoyed working in Royal Mail, the same as the previous year;
- (f) the main strategic programmes were showing varying levels of progress: SDD, as had been reported before to the Board, was complete in some 94% of units with the sustainability of the benefits an issue; six flat sorting machines were now in operation, with the challenge being to secure the planned headcount reductions; mail centre review revisions and benefits were on track; and the financial services JV in Post Office Ltd was showing a lower than forecast level of take-up of personal loans;
- (g) the draft half-year results showed a profit from operations of £217m, which was £73m and £161m favourable to budget and prior year respectively. Profit before tax was £55m, £19m adverse to budget, but £52m favourable to the prior year. The results were still subject to review by the auditors, and would be presented to the Board on 2 November, with publication scheduled for 18 November;
- (h) turning to the full-year forecast, as the half-year position was £73m favourable to budget, and the £82m central contingency had not yet been called upon, the business appeared to be on track to exceed the £400m target, possibly by a substantial margin, with some flexibility to manage Quality of Service. However this would require revenue to continue to compensate for the people cost overruns in the Letters business;
- (i) The Board approved the proposed timetable for the authorising of the half-year accounts as set out in Marisa Cassoni's paper RMH(04)152. The Board also noted that the half-year accounts would include a charge of some £80m relating to the first half charge to the accounts of the *Share in Success* scheme.

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- RMH04/173**                      **ALLOWABLE PROFIT FOR THE REGULATOR - RMH(04)153**
- (a) The Board noted Marisa Cassoni's paper. The paper was not discussed in detail: it was agreed that it would need to be considered further in the light of the development of the strategic plan.
- RMH04/174**                      **BALANCE SHEET RESTRUCTURING - RMH(04)154**
- (a) The Board noted Marisa Cassoni's paper.
- RMH04/175**                      **RESERVED POWERS AND DELEGATED AUTHORITIES FRAMEWORK - RMH(04)155**
- (a) The Board noted Marisa Cassoni's paper which proposed for the Board's approval an updated framework of reserved powers and delegated authorities. The changes proposed to the previous set agreed by the Board in July 2002 were in the main to reflect changes in organisational structure, and to ensure that controls were clear. The Board noted that the proposals had been reviewed extensively by the Audit and Risk Committee;
- (b) The Board approved the proposals for delegated authorities, subject to removing from the framework the budget offset arrangements for unbudgeted items - a principle with which the Board disagreed;
- (c) On the proposals for the establishment of an Investment Committee, Sir Mike Hodgkinson raised a concern that the implication of the proposal would be to remove the power from the Post Office Ltd Board to approve investment cases - in his view this would be counter to the rationale for setting up POL as a separate company within the Group, as had been agreed with Government. The Board agreed that Sir Mike should review this element of the proposals with Adam Crozier. Subject to resolving that point, the Board agreed the new investment authorisation arrangements.
- ACTION**  
**Sir Mike**  
**Hodgkinson/**  
**Adam Crozier**
- RMH04/176**                      **CORPORATE RISK SCORECARD - RMH(04)168**
- (a) The Board noted the paper which set out the latest proposals, reviewed by the Management Board in September, for a scorecard of corporate risks for Royal Mail Holdings. The Board endorsed the content of the paper, and noted that the risks would be re-validated when the strategic plan had been completed.
- RMH04/177**                      **ROYAL MAIL PENSIONS TRUSTEES LTD ANNUAL REPORT - RMH(04)157**
- (a) The Board welcomed Gerry Degaute to the meeting, who presented the annual report to the Board on behalf of the Trustee Company. The Board noted:
- (b) the Fund's assets had grown in value by £3.3bn to £15.3bn over



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the year to 31 March 2004;

- (c) membership of the pension plan had been fairly static at nearly 440,000, although the membership profile had changed with a reduction of some 14,000 employee members, with a net increase of 12,000 pensioners and deferred pensioners;
- (d) the interim valuation for March 2004 was to be discussed by the Trustee Company at its October meeting, and was likely to show an increase in the funding level to 85.1% compared with 82.6% at the March 2003 full valuation. The increase was due mainly to additional employer contributions and better than expected investment experience;
- (e) the revised investment policy discussed with the Company earlier in the year - to reduce holdings in equities from 50% to 40%, and increase holdings in property and bonds - was being introduced gradually to take the maximum advantage of market conditions and cash flows;
- (f) overall the Fund had outperformed its benchmarks by over the past three years by 1% per annum on average;
- (g) the performance of the membership administration unit in Chesterfield had been good, with most agreed service targets having been met. A new computer system had been installed during the year, and in the main it had bedded in well;

The Board noted further in discussion:

- (h) the impact of the Government's pension protection proposals was not yet clear, but it was estimated that they could have a possible cost impact of up to £9m for the Royal Mail pension schemes;
- (i) Bob Wigley asked about the arrangements made to ensure that the trustees were suitably qualified for the role. Gerry Degaute explained that trustee appointments were made by Royal Mail, who satisfied themselves that nominees were competent for the role. There was a comprehensive set of induction arrangements provided by RMPTL, together with regular opportunities for trustees to have ongoing training and attendance at relevant seminars;
- (j) The Chairman thanked Gerry Degaute on behalf of the Board for his presentation and for RMPTL's effective stewardship of the Company's pension schemes.

**RMH04/178**

**ROYAL MAIL STRATEGY - RMH(04)156**

- (a) The Board discussed Adam Crozier's paper which set out a draft version of the strategic plan for the Letters business. The purpose of the agenda item was to gain reactions from the Board, before the plan was developed further. The strategic plan would be put to the Board for formal approval later in the year. A

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separate record of the summary of directors' comments on the plan is attached.

**RMH04/179****POST OFFICE CARD ACCOUNT SERVICE FAILURES - RMH(04)158**

- (a) The Board noted David Mills' paper.

**RMH04/180****POST OFFICE CARD ACCOUNT VAT RISK - RMH(04)161**

- (a) The Board noted David Mills' paper.

**RMH04/181****PROJECT BILL PAYMENTS - RMH(04)159**

- (a) The Board noted David Mills' paper. The Board would be informed of how and to what timescale POL would be targeting activity in the bill payment market to address the profit shortfall resulting from the acquisition of the Alliance and Leicester bill payment business.

**RMH04/182****POST OFFICE FINANCIAL SERVICES HOME INSURANCE - RMH(04)160**

- (a) The Board noted David Mills' paper.

**RMH04/183****GROUP INVESTMENT 2004/05 QUARTER 2 REPORT - RMH(04)162**

- (a) The Board noted the report, in particular the activity underway to increase the Company's shareholding in NDC2000 Limited and to change the existing terms of the options on the Company's shares, designed to enable NDC2000 Limited to remain in the Royal Mail VAT group.

**RMH04/184****ROYAL MAIL VEHICLE REPLACEMENT PROGRAMME 2004/05: QUARTER 4 ACQUISITIONS - RMH(04)163**

- (a) The Board noted Adam Crozier's paper, and noted further:
- (b) the full-year vehicle acquisition programme had been authorised by the Board on 3 May 2004, at a level of £112.5m for 9819 assets. The Board had devolved authority for the approval of each quarter's acquisitions to the Management Board;
- (c) cumulative to quarter 3, the Management Board had authorised £70.0m on 5404 assets. The quarter 4 acquisition authorised was £38.8m capex for 3846 assets, bring the total vehicle acquisitions to £108.8m, some £3.7m below the Holdings Board's authorised sum. The anticipated impact of the P&L was £23.8m.

**RMH04/185****REGULATION REPORT – RMH(04)164**

- (a) The Board noted the report.

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**RMH04/186**

**ACCESS PRICING - RMH(04)165**

- (a) The Board noted the paper.

**RMH04/187**

**GROUP TREASURY REPORT - RMH(04)166**

- (a) The Board noted the report.

**RMH04/188**

**COMPANY SECRETARY'S REPORT – RMH(04)148**

- (a) The Board noted the report.

**CLOSE**

In the absence of any further business, the Chairman closed the meeting. The next meeting was scheduled for Tuesday 2 November 2004, at 148 Old Street, London.



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**ROYAL MAIL HOLDINGS plc BOARD - 5 OCTOBER 2004**

**DISCUSSION OF DRAFT STRATEGIC PLAN - SUMMARY OF DIRECTORS' COMMENTS**

Sir Milke Hodgkinson

- some big issues involved, some of which would not be easy
- need some background papers on
  - labour market to understand what we need to do
  - pricing to understand what we are trying to achieve in markets compared with what might be politically acceptable
- what difference would it make if the plan took 10 years to implement rather than 5?
- how should it be presented to the regulator?
- would phasing the plan assist? - ie trialling some elements of the plan before rolling out
- would a move to self-billing for large customers be significant?

Bob Wigley

- supported MH's comments
- draft strategy was a good document - challenges status quo, likes focus on simplicity, and it being customer-led
- does it sufficiently recognise the scale of cultural change needed?
- is the requirement for change management sufficiently understood?
- the technology programme is huge - given RM's track record, would need superb project management skills to see this through

John Neill

- supported previous comments
- liked mission and vision statements
- big concern was lack of an operational strategy - possibly a £600m risk (as identified on corporate risk register)
- an ops strategy is more important than automation
- would rather spend £600m on improving management than on VR
- pension deficit is big issue
- company needs a mindset change from "good enough will do" to passion for excellence
- need effective means of policy deployment to ensure strategy is delivered

David Fish

- needs a bigger concentration on selling products - need to think more about better product definitions
- labour assumptions are too tight - need to get to £400 per week within 5 years to attract better people
- too much capex - not enough peoplex
- pricing assumptions too aggressive for customers and government

Richard Handover

- need more on competitive landscape to show strategy is on right lines
- people issues are key, and are not fully addressed
- supported John Neill's views about need for operational strategy
- concerns about management capability to deliver

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- what are the lynchpin plans which would need to have priority?
- do we need to be more radical?

### Allan Leighton

- good template to think through issues
- despite plan's big headcount reductions, company would still be a big people-business.  
Plan needs to address how to make people feel more in tune with RM
- £300 pa is not enough for Share in Success
- must fix DOMs and MC managers
- take out non-delivery work from DOs
- need more focus on looking after top 100 customers

### Summary

- good framework
- need to put more investment into people to raise quality and improve morale - need £400 pw in year 5
- less capex to realistically manageable levels
- need to do a top-down business model which has the givens of:
  - £400 pw for front line, better bonuses, more in Share in Success
  - politically acceptable prices
  - base levels of capexand then see how plan looks.

Board will review again at special meeting to be fixed before next full Board meeting.