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To: Secretary of State and Jenny Willott

From: Peter Batten **GRO**

Date: 26 March 2014

Subject: Briefing for meeting with National Federation of Subpostmasters – Thursday 27 March

Purpose: You are meeting George Thomson, General Secretary of the National Federation of Subpostmasters (NFSP) for an introductory meeting.

Attendees: George Thomson (General Secretary, NFSP); Richard Callard (Shareholder Executive)

Timing: Scheduled for Thursday 27 March, between 16:00 and 16:30 in your BIS office.

Background:

1. There is currently a positive and supportive relationship between NFSP and Post Office Ltd (POL) following the intensive engagement to develop the new strategic plan, which includes revisions to the Network Transformation (NT) programme. However, the NFSP's relationship with HMG is tempered by the perception that HMG could be doing more to support POL deliver its Front Office ambitions. George may also wish to discuss mutualisation, and the future structure and role of the NFSP.
2. You may wish to discuss future competitive pressures on the Post Office network, and the upcoming NFSP annual conference (in May, where you are speaking)

Network Transformation

3. There has been a marked increase in the rate of conversions (both contracts and branch openings) since the turn of the year. Over the last eight weeks the level of activity has nearly doubled:

		Total	Weekly average
First 43 weeks of financial year	Contracts signed	513	64
	Branches opened	370	46
Most recent 8 week period	Contracts signed	1062	25
	Branches opened	1037	24

4. As of Friday 21 March, there were (x) branches signed to convert, of which (x) had actually been modernised and reopened.
5. Although there has been some highly localised opposition to the changes to the NT programme, POL has been successful in mitigating the risk of widespread opposition. This is due in large part to the support of the NFSP, who have endorsed the new approach, and have been jointly involved in hosting road shows for subpostmasters (SPMs). Although the changes to NT allow POL to take a more direct approach in requiring SPMs to convert to the new models, the programme is still operating voluntarily, and is therefore still relatively uncontentious in practical application. You can usefully reiterate your support for NT, and seek confirmation of the NFSP's continued support for the programme. Mervyn Jones, NFSP Commercial Director, sits on the NT Programme Board.

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Relationship with the NFSP

6. As a result of NT the NFSP is currently facing up to the challenge presented by a network with fewer standalone subpostmasters and therefore a smaller membership and less influence (e.g. NT will see more post offices operated by existing retailers who are less likely to sign up to membership). POL recognises this, however it also accepts there is a long term role for a body that represents people that deliver post office services. It is working with the NFSP to understand how a relationship between two closely aligned organisations might work in the future (e.g. with the NFSP as a trade association). These discussions are between POL and the NFSP, and HMG plays no role.

Subpostmaster income (including Front Office)

7. George has been continually critical of HMG for what the NFSP sees as a failure to deliver new government services revenue through the post office network (see article attached at Annex A). We have always been clear that it is not within HMG's gift to simply award work to POL, but that contracts must be won in accordance with EU procurement regulations that ensure tenders are competitive, drive innovation and deliver value for money.
8. There is a positive story to tell, which includes the fact that POL has won every government contract that it has bid for since March 2011 (when it lost the £10m Green Giro contract). However, the value and volume of these contracts have not been as great as was imagined in 2010.
9. A key criticism is that where contracts have been won, such as the DVLA framework contract, these are on reduce transaction fees, representing a cut in income for SPMs. While this is true, it is unavoidable in the context of a competitive marketplace, and the alternative would have seen POL's competitors winning the work, and SPMs losing income and customers entirely. You will be able to point to the work that you are doing across Whitehall to raise awareness of the Post Office as a front office provider, including you presentation to PEX(A) and recent meetings with Maude.
10. It will be important to guide George to understanding that although government work remains an important revenue pillar for the Post Office, and for SPMs, the NT programme is helping position the network to take advantage of new revenue opportunities, which include new mails services such as Click and Collect, and new financial products such as mortgages and current accounts.

[INSERT GRAPH SHOWING INCOME SPLIT BY PILLAR]

11. George may also raise the fall in mails income seen this financial year. This followed a decision by Royal Mail to change the pricing structure for small parcels, which resulted in a significant (x%) drop in parcel revenues compared to budget forecasts. Royal Mail introduced a new parcel pricing structure in October 2013 to address the loss of business, but this has not been sufficient to recover the losses incurred over the first half of the financial year.
12. It is likely that George will claim that this is the result of separating Royal Mail and POL, and future issues will arise as Royal Mail is no longer directly connected to its

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customers (who are served through the Post Office). He may call for HMG to retain its 30% shareholding in Royal Mail and use this to influence Royal Mail in the future.

13. We must be clear that HMG is now on the same footing as any other shareholder in Royal Mail, and has no special influence over strategic decisions. In response to the parcel pricing issue, POL and Royal Mail have established a group to discuss proposed product changes. Although Royal Mail retains complete discretion over pricing matters, this is an important and useful channel for POL to influence Royal Mail.

Mutualisation

14. POL has made steady progress towards mutualisation over the past 18 months since BIS published its response to the public consultation on POL's mutualisation. This has included convening a Stakeholder Forum to develop a "public purpose" of the post office – this is a "purpose" around which a mutual can be built and is a key milestone on the road to mutualisation.
15. POL is planning to publish this "public purpose" soon, alongside a list of other milestones that mark a path to mutualisation. This approach was agreed between POL and Jo Swinson in November when the new funding was announced and this is an important opportunity for POL to signal what has been achieved to date and the steps it will be taking in the future.

It is envisaged that this will be published in April and you have given POL a strong steer that working to this timescale is important. This will be an important step in the process which should be welcomed by the NFSP who have, in the past, questioned POL's commitment to make progress towards mutualisation.

POL central costs

16. The NFSP has, and remains critical of POL's central costs, and suggest that the company is not reducing costs as quickly as it could, and that this is a drain on the wider network. They will point to the reduction in subpostmaster pay this year (due in large part to the Royal Mail parcel issue) as being in contrast with the stability enjoyed by salaried POL employees. We continue to be clear that although we support the efficient and optimal operation of POL, this necessarily encompasses strategic; product development; client (i.e. Royal Mail and Government) negotiator; IT; and cash support services. ShEx continues to push POL to develop and deliver a central cost reduction plan under the broad heading of "Business Transformation" that is cognisant of the wider business requirements for an efficient business that operates over 11,500 branches.

Copied to: Perm Sec MPST; Spad MPST; ShEx Post Office team; Anthony Odgers

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Speaking Notes / Questions to ask:

	Points to draw from:
Funding	<ul style="list-style-type: none"> • Securing £640m funding for the period 2015 to 2018 was a major achievement. This is a sign of this Government's commitment to the Post Office • In turn, it is absolutely vital for the Post Office to deliver on the agreed strategic plan, including delivering Network Transformation to time and budget.
Network Transformation	<ul style="list-style-type: none"> • I was very pleased to see the NFSP supporting the reforms of the Network Transformation programme. I hope that this heralds a new and productive period in your important relationship with the NFSP and subpostmasters. • Recent progress under the Network Transformation programme has been encouraging; can you assure me that lessons are being learned that will ensure the rate of branch openings will be improved?
Mutualisation	<ul style="list-style-type: none"> • This is an area that is very important to me and my Ministerial colleagues. Jo Swinson announced last year that you would publish an update on mutualisation shortly. I am looking forward to this in the coming weeks. • What do you see as the key steps towards mutualisation over the next twelve months, and in the longer term?
<u>[If raised]</u> Government Services Revenues	<ul style="list-style-type: none"> • I continue to lend my support to the Post Office's ambitions to become a Front Office for Government. However, in the context of continued budgetary restraint, it is incumbent on the Post Office to demonstrate that it is delivering value-for-money for the taxpayer. • Jenny and I continue to act as the Post Office's "cheerleaders" across wider Government, but it is crucial that the Post Office starts thinking of the Government as a customer.
<u>[If raised]</u> Mails revenues	<ul style="list-style-type: none"> • The Post Office is an independent business that has a commercial agreement with the Royal Mail. The Government cannot be involved in commercial matters, and it is your responsibility to negotiate effectively and in your company's best interests. • As a regular shareholder, the Government has no special influence over the Royal Mail.

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[If raised] Horizon accounting software	<ul style="list-style-type: none"> • I understand that you have established a Working Group with an independent Chairman. I am conscious that this working group must be seen to be independent, and cannot comment at this stage.
[If raised] Business Trans- formation	<ul style="list-style-type: none"> • I understand the importance of transforming and modernising the business. I would urge you to consider the range of skills required to deliver the necessary changes. • And to work closely with my officials to ensure that all options are appropriately assessed, and are deliverable from a commercial, strategic, and political perspective.

Revenue from Government services

17. You and Jenny continue to act as champions for POL across Whitehall, but Paula may flag a risk to delivery of POL's strategic plan if certain existing Government contracts are renewed on weakened terms (e.g. POCA with DWP) or if opportunities that have been identified are delayed (e.g. ID assurance and assisted digital with Cabinet Office). You can assure POL that you continue to support their ambitions to be the front office of government, but that they must continue to show they represent value for money for the taxpayer by engaging commercially with Departments.

Revenue from mails

18. Mails revenues will be lower in 2013/14 compared to 2012/13, and POL may seek to provide an explanation by suggesting that the fall is a result of poor pricing policy by Royal Mail. It would be helpful for you instead to draw attention to the need for POL to prepare fully for the mid-term review of POL's contract with Royal Mail, which will take place in 2016/17 – e.g. by being innovative and customer oriented and by making sure POL delivers the transformation of the post office network. It is possible that Royal Mail might seek to renegotiate some contractual terms in 2016/17, which could have a material impact on POL's financial performance.

The integrity of POL's 'Horizon' accounting software

19. All in-branch transactions performed by subpostmasters and POL staff are recorded by POL's accounting software, known as 'Horizon'. Shortly after joining POL and in response to low-level but persistent grumblings by a small number of former subpostmasters, Alice commissioned a review of the integrity of the Horizon system. An independent report, published in July 2013 found there were "no systemic" issues with the software, but made recommendations about POL's processes for handling financial irregularities in subpostmaster accounts.

20. Following the report, POL has worked with a group representing the former subpostmasters and the report's author (a small firm of forensic accountants called Second Sight) to establish a working group under an independent Chair that has set up a mediation process for former subpostmasters who feel wronged by the Horizon system. The working group has received 147 submissions, but has not yet agreed its terms of reference. POL may choose to raise this with you; however you should avoid being drawn on the matter at this stage as HMG involvement risks the

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independence of the working group, and involves Ministers in an operational matter. Further specific advice will be submitted to you shortly.

Business transformation

21. As part of its strategic plan POL will be undertaking a review of its business model to ensure that it has the right structure to deliver its strategy effectively. Given the marked change in POL's business and its network over the last 25 years this is likely to lead to a number of recommendations suggesting a restructuring of a variety of business processes (e.g. supply chain, finance function, IT delivery, network management) – together these will not only help to reduce costs but they will also make sure that POL is structured for a growing future. It is important that POL takes the right decisions following this review, and to meet its targets some of these decisions are likely to be difficult to make (e.g. challenging long established business practices). All options are currently being considered and you should encourage Alice and Paula to wait for the review to end, and then to consider the commercial, strategic and political costs and benefits of each option. It would also be recommended for them to engage with the ShEx team to ensure plans are deliverable and assessable.