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To: Martin Donnelly
From: Peter Batten GRO
Date: 04 April 2014

Subject: Briefing for meeting with Post Office Ltd Chair

Purpose: You are meeting Alice Perkins, Chair of Post Office Ltd (POL) on 8 April. This briefing covers the company's recent progress on key issues.

Recommendations: That you:

- Note 2013-14 was challenging, but POL has set a stretching budget for 2014-15;
- Are clear that the company will come under increased scrutiny, particularly around Network and Crown Transformation in the run up to the General Election;
- Secure Alice's support to publish POL's public purpose and mutualisation milestones in the immediate future;
- Challenge Alice to ensure POL works commercially with DWP to secure a positive outcome to the ongoing Post Office Card Account (POCA) negotiations; and
- Note risks around the Valuation Office Agency and Horizon Working Group.

Background information:

1. Since 2010, HMG has committed nearly £2bn to support POL in maintaining and modernising the post office network. £1.34bn was announced in 2010, and covers the period to 2015. Following last year's agreement with POL's strategic plan, HMG is providing a further £640m funding for the period April 2015 to March 2018 to enable a network of at least 11,500 branches to be maintained.

Financial performance

2. POL has faced a challenging year financially, with POL unlikely to meet expected revenue targets. This poor performance can be partially attributed to Royal Mail pricing policy negatively affecting forecast mails revenues. POL has retained its strategic plan forecast for 2014-15, which ShEx believes to be ambitious and stretching.

Network and Crown Transformation

3. Network Transformation (NT) is central to POL's strategic ambitions. By introducing new operating models that remunerate subpostmasters on a transaction-only basis, NT reduces POL's high fixed cost base, making the company more financially sustainable and reducing its reliance on taxpayer subsidy. It also improves branch environments and extends opening hours, helping post offices to retain and win customers and clients. NT is crucial to the eventual mutualisation of POL.
4. Following an agreed change of NT strategy in November 2013, POL has finished the 2013-14 reporting year strongly, with over 3,200 branches signing contracts to convert to the new lower cost operating models, and over 2,000 having physically converted.

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5. The POL strategic plan, also agreed in November, sees the completion of the NT programme in 2017-18. POL must continue the recent good progress that has been achieved to meet this target. Danny Alexander has expressed a particular interest in Network Transformation, and in light of the very significant funding committed this Parliament, will be increasingly interested in the programme. You can usefully reinforce this message with Alice.
6. The Crown Transformation programme (CTP) aims to modernise 300 directly owned and operated branches; seek franchise partners for 70 branches; and achieve run-rate breakeven by March 2015.
7. The company is on track to complete the modernisation of the 300 branches it is retaining by November 2014 and is beginning to franchise the 70 branches that it does not believe it can bring to profitability. Progress towards financial run-rate breakeven by March 2015 is dependant on cutting costs and growing revenues. The company is confident of cutting costs through a union supported voluntary redundancy programme, increased automation, and franchising some branches. However, revenue growth is susceptible to shocks, such as Royal Mail pricing decisions, and pay negotiations with the CWU are at a difficult stage.

Mutualisation

8. POL has made steady progress towards the long term goal of 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.
9. 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. You can usefully encourage Alice to ensure that POL does publish these documents, most helpfully before the NFSP conference on 12 May where Jenny Willott will be speaking.

Post Office Card Account (POCA) negotiations with DWP

10. The POCA contract with DWP that provides access across all branches to pension and benefits expires in March 2015. POCA customers typically do not have bank accounts, and many are deemed to be "unbankable". However, DWP policy is to reduce the cost of paying pensions and benefits by migrating POCA users to bank accounts. DWP sees this as especially important for working-age claimants who will be migrated to Universal Credit which is designed to be paid into bank accounts.
11. POL and DWP are in commercial negotiations to ensure an extension and a successor product to POCA that is focussed on pensioners (who will not be moved to Universal Credit) while allowing time to migrate those working-age who are able to do so, onto banking accounts. The negotiations are complex and difficult. ShEx officials and Jenny Willott are engaging DWP to influence and inform the process, but you can reinforce the need for POL to fully *understand DWP as a customer*, and to develop a compelling and commercially competitive proposal.

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'Horizon' and Valuation Office Agency (VOA) risks

12. 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 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 training and support processes.
13. Following the report, POL has worked 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 progress has been extremely slow and there is a potential presentation risk. The POL Board is seized of the need for a swift conclusion to this issue and is working to identify solutions.
14. The VOA is still proposing to implement proposals that would see subpostmasters with externally facing POL ATMs become separately liable for business rates. You are aware of the background to the situation. BIS continues to believe that the VOA position is misinformed, and is continuing to engage the VOA to test their rationale. Should the VOA implement their proposals, there remains a very serious handling risk, and a substantial financial impact on either subpostmasters individually, POL, or HMG (depending on HMG response). ShEx is engaging POL appropriately, but dialogue is limited as the discussions are currently between BIS and HMRC lawyers.

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