

RESTRICTED – POLICY AND COMMERCIAL

To Edward Davey
From Post Office Network Team
Date 214 October 2011

**Meeting with Alice Perkins, Chair - Post Office Ltd
12:45-13:30 Thursday 27 October 2011**

Purpose

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

Attendees

Alice Perkins (POL), Will Gibson (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 how important it is the importance that POL reduces its long-term reliance on subsidy, through the successful implementation of its commercial strategy.
- If raised, to make clear the importance that ShEx has a presence on the POL Board following operational separation from Royal Mail.

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 Vince Cable on 3 October).

Background

Alice's appointment as Chair was approved in July, and is first step in establishing the new, separate and robust governance arrangements that are necessary for POL to be successfully separated from Royal Mail.

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** have been progressing in recent months, and agreement is expected during November by the end of October, with the businesses becoming operationally separate when the pension deficit solution is implemented

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(expected March 2012). Separation proposals are due to be put to the POL Board on 10 November and Alice will be able to update you on progress in negotiations.

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 ~~will~~should be aware that we have been clear to Alice that it is your and Vince Cable'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. Alice voiced some reservations about this in her introductory meetings with the Secretary of State and Martin Donnelly. ~~You may recall that prior to her meeting with the Secretary of State we sought your view on this issue once again.~~ The Secretary of State was firm with Alice that ShEx should take a Board seat, and after further discussions with you last week the Secretary of State has sent we are proposing that a letter to Alice issue from the Secretary of State prior to Thursday's meeting to close the discussion downseeking to end discussion on the matter. However, ~~though~~ Alice may also wish to test her views with you. As you are aware, 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 the Annex, along with a copy of the Secretary of State's letter).

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 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". POL has pitched this as providing more face-to-face services on Government's behalf, helping Government to make savings and move towards digital delivery by outsourcing these transactions. ~~POL has secured some small contract wins – some through being a prime bidder and some by partnering. However, they lost the DWP contract for the cheque replacement service, and there have been some reservations on their ability to manage the tender process. Recently, UKBA has given their intent to award their biometric residency permit enrolment service to POL, and the day of your meeting with Alice is the last day of the stand-still period, during which other bidders can challenge the award. Alice is also meeting Jeremy Heywood on 27 October, immediately before her meeting with you.~~

~~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 the current tender for UKBA work is expected imminently (NB – this may become known between the submission of this briefing and your meeting with Alice, in which case we will update you immediately).~~ Following your recent

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presentation to PEX(ER), Stephen Lovegrove has written to the commercial directors of OGDs to encourage them to engage with POL, on a without prejudice basis, and we are in the process of setting up key meetings (including with HMRC, DWP and DH), in developing their future service offerings and to suggest they meet with Will Gibson, as a result. Senior POL and Shex teams are meeting at the end of November to agree strategic comms for GS.

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 to date. POL is not planning to submit a formal response; instead proposing to continue to engage with you and officials on a more informal basis (ie through papers, meetings and calls) so that business requirements are fully understood and incorporated. Alice has voiced some concern to officials that POL is under-resourced to engage effectively in the process to develop mutualisation proposals, given other priorities (eg separation and the implementation of the commercial strategy). POL is considering how best to input into the current consultation; deciding whether to submit a formal response or instead continuing to engage with you and officials on a more informal basis (ie through papers, meetings and calls) so that business requirements are fully understood and incorporated.

You met Alice prior to her appointment.

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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"> • It was good to meet you prior to your appointment and I am very glad that you are now in position in the important role of POL Chair. • I am also pleased that Neil McCausland has joined your Board as Senior Independent Director. • I'm keen to hear more about your plans to develop the Board and ensure the right balance of skills and expertise is present. • I understand that you are interviewing possible candidates to Chair the Audit and Risk Committee. Are you in a position to provide an update on progress? • 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. • I understand that negotiations on the Master Services Agreement and Mail Distribution Agreement are progressing. Getting these right will be critical for the future of POL. <u>How are negotiations progressing?</u> • To ensure the right commercial contracts are in place, POL clearly needs an independent and robust Board to represent its interests in the negotiations and that is why your appointment is so important. • <u>[If raised and the letter has issued] I understand the Secretary of State wrote to you this week to confirm that a Shareholder Executive official will join the POL Board on separation from Royal Mail next spring.</u> • <u>[If raised]</u> 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. • <u>[If raised]</u> 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 <u>and generous</u> SR settlement. Its successful implementation is a key <u>Ministerial</u> priority <u>of mine</u>, 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

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	Board support and oversight.
<u>Commercial Strategy: Government Services</u>	<ul style="list-style-type: none"> • <u>Government services form a key part of the Commercial Strategy – UKBA is good news, but there is still a long way to go.</u> • <u>It is fundamentally important that POL offers a compelling commercial offer to win Government contracts. The DWP Green Giro (SMOTs) contract experience shows that Government cannot simply award contracts to POL.</u> • <u>Very important that you as Chair are clear that POL has the skills and resources to enable them to deliver on the Government Services growth they put forward to us in the commercial strategy.</u> • <u>I understand you met Jeremy Heywood earlier today to discuss this – how did the meeting go?</u> <p><u>If POL's procurement status is raised:</u></p> <ul style="list-style-type: none"> • <u>Previous legal advice suggests that POL would not qualify for direct award of contracts through a crown-to-crown exemption, largely because the bulk of POL's revenue is from private sources.</u> • <u>My officials are revisiting this issue as a matter of good practice, and will engage with POL as part of this. However, the current expectation is that POL's status will remain unchanged.</u> • <u>As competition Minister I also clearly have an interest in ensuring the benefits of procurement – innovation, service quality and VfM for the tax payer – are met.</u>
<u>Commercial Strategy: Network Transformation</u>	<ul style="list-style-type: none"> • <u>The next year is particularly important for the network as new operating models are developed and implemented.</u> • <u>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.</u>
<u>Mutualisation</u>	<ul style="list-style-type: none"> • <u>We have now begun our consultation on developing a mutual ownership model for POL.</u> • <u>I appreciate that mutualisation can only happen once POL has successfully separated from Royal Mail and implemented its commercial strategy and these are clearly the key immediate priorities.</u> • <u>But it is critical that any mutual structure and any transitional arrangements strike the balance between developing the mutual culture of engagement among stakeholders and ensuring that management can get on with running the business to deliver success.</u>

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	<ul style="list-style-type: none">• <u>It is therefore vital that we have sufficient input from POL into the mutualisation consultation – whether through a formal response or otherwise – to ensure we achieve that balance.</u>• <u>We will continue actively engaging with you and the POL team as we develop our response to the issues raised by the consultation and as the policy develops thereafter.</u>
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CC list CableDavey MPST; Perm Sec MPST; SPAD MPST; Stephen Lovegrove; Susannah Storey; ShEx POL team; Josh Coe.

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Annex – 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 was originally made by you and the Secretary of State this spring, and was reconfirmed by you earlier 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 you after that meeting and you again reiterated your strong feeling that ShEx should take a Board seat.
- Stephen Lovegrove spoke to Alice in advance of her meeting with the Secretary of State, to pass on your views.

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 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.

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BIS | Department for Business
Innovation & Skills

The Rt Hon Vince Cable MP
Secretary of State for Business
Birmingham 2, 1st Floor

Alice Perkins
Chair
Post Office Limited
148 Old Street
London
EC1V 9HQ

25 October 2011

Alice

Post Office Limited Board Composition

It was a pleasure to meet you on 3 October and to hear your thoughts about your new role as Chair of Post Office Ltd. As you rightly pointed out at that meeting, much progress is already being made but there continue to be major issues for the business to focus upon over coming months. Separation from Royal Mail, building up the Front Office for Government offering and rolling out the network transformation programme are perhaps just the three most prominent.

I am therefore very pleased that the Post Office senior team have you to support them in those endeavours. To the same end I am also delighted at the swift progress you have been making in making further appointments to the board. From our discussions I could tell that you have clearly hit the ground running over your first few weeks and I would like to thank you for it.

At our meeting you raised the issue of whether it was best for an official from the Shareholder Executive to join the Post Office board from the point of separation from Royal Mail next spring. Since then I have reflected further on your views but I have concluded that I should confirm to you my initial decision. This practice embeds constructive, candid and open relationships between the Shareholder Executive and the boards of its portfolio businesses, and the vast majority of portfolio businesses now have a Shareholder Executive board representative. I firmly believe that the already extremely positive relationship that exists between Post Office management and the Shareholder Executive team would therefore be further enhanced by this move. Importantly, such an appointment would also ensure necessary Government accountability for the investment it is making in the business over the spending review period.

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Enquiries

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I would also like to reassure you that any Shareholder Executive appointee would be subject to the full range of legal duties applicable to other directors. So there would be no risk that such an appointment would lead to any diminution of the arm's length relationship between Government and the business.

I will write to you in more detail in a few weeks' time to set out in more detail my objectives for the Post Office over the next few years. However, given its relevance to your ongoing work to form the Post Office board, I thought you would appreciate clarity on this one issue at an early stage. Stephen Lovegrove will be discussing with you the identity of the individual the department nominates in the coming days.

GRO

VINCE CABLE