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**RMH(11)9TH**
**RMH11/136- 149**

**ROYAL MAIL HOLDINGS plc**
(Company no. 4074919)
**Minutes of the meeting of the Board of Directors held at 100 Victoria Embankment, London, on 14 December 2011**

**Present:**

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| Donald Brydon | Chairman |
| David Currie | Non-Executive Director |
| Moya Greene | Group Chief Executive |
| Mark Higson | Managing Director, Operations and Modernisation |
| Nick Horler | Non-Executive Director |
| Cath Keers | Non-Executive Director |
| Matthew Lester | Group Chief Finance Officer |
| Paul Murray | Non-Executive Director |
| Orna Ni-Chionna | Non-Executive Director |
| Les Owen | Non-Executive Director |
| Paula Vennells | Managing Director, Post Office Ltd (for RMH11/136-RMH11/145) |

**In attendance:**

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| Jon Millidge | Company Secretary |
| Sue Whalley | Regulation and Government Affairs Director (for RMH11/141) |
| Rico Back | Chief Executive, GLS |
| Frank Schinella | Deputy Finance Director (for RMH11/142) |
| Jeff Triggs | Interim General Counsel (for RMH11/142 and RMH11/145) |
| Stuart Simpson | Finance Director, Modernisation and Operations (for RMH11/143) |
| Mark Thomson | Olympic & Interim International Director (for RMH11/146) |

**RMH11/136 MINUTES OF PREVIOUS MEETING - RMH(11)8TH**

(a) The Board approved the minutes of the meeting held on 26th October 2011;

(b) the Board noted the minutes of the POL Board dated 10 November 2011. The Board noted that it would be asked to approve the formal agreement on Project Black Eagle and asked that a paper on the negotiations be submitted to the Company Secretary for circulation to the Board;

**ACTION: Paula Vennells**

(c) the Board noted the minutes of the Audit & Risk Committee of 17 November 2011.

**RMH11/137 MATTERS ARISING - RMH(11)112**

(a) The Board noted the status report.

**RMH11/138 CHAIRMAN'S BUSINESS**

(a) The Chairman noted that good progress had been made on the discussions between Royal Mail and Post Office on the separation issues, and that both sides had reported that all substantive issues had been resolved. The Board expressed its thanks to those

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involved;

(b) the Board noted that Les Owen had indicated his intention to resign from the Post Office Board because of the potential for conflicts of interest to emerge. The Chairman of Post Office Ltd had asked Les Owen to stay until a replacement could be found and he had agreed subject to being able to manage any conflicts. The Board also noted that for similar reasons, Paula Vennells' position on the Royal Mail Holdings Board was currently being discussed between the two Chairmen. As part of this discussion, consideration was being given to the process for approving the Post Office Ltd budget for 2012/13;

(c) the Chairman reminded the Board that his period of appointment as a director would reach three years in January 2012 and that the Shareholder Executive had asked him to stay as Chairman for a further three year period. The Chairman had expressed an intention to do so and was subject to arrangements with the Shareholder Executive;

(d) the Chairman had recently met with Dave Ward, Deputy General Secretary, to share with him the main issues that the Board would discuss at this meeting and to allow Dave Ward to express views on the issues which would be relayed to the Board. The Chairman reported that the meeting had been open and productive, and that it would be a regular feature and would remain confidential. Dave Ward had expressed a view that the Company had not made sufficient progress on innovation and growth, and was keen that the CWU should have a role on pushing those agendas forwards. He had also advised that the CWU had started to make progress on their thinking around the proposed employee share scheme and it was agreed that this would be given more impetus;

**ACTION: Jon Millidge**

(e) the Chairman advised that progress was continuing on finding the BPMA a new home. The Board agreed to continuing funding the BPMA at a level of c£1m pa for a period of 20 years;

(f) the Board noted that an inquiry into dog attacks on our people would be announced shortly and that a reputable judge had been identified to lead the inquiry.

**RMH11/139 REPORTS FROM THE CHAIRS OF BOARD COMMITTEES**

(a) Pensions Committee: The Board noted that this item would be covered later on the agenda;

(b) Audit and Risk Committee. Paul Murray reported that the ARC had met on two occasions since the last Board meeting. The first meeting was convened to review the interim financial results, to note the Going Concern position and to discuss the approach to the year end audit with Ernst & Young. Because of events, the ARC had also reviewed an interim report on the investigation into irregularities in the management of iRed. A fuller report was expected in February.

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The second ARC meeting had reviewed specific projects on IT resilience and IT security. Both had identified an unsatisfactory position that was not a surprise to management, and actions had been identified to provide more comfort in this area. Reports on the recording of benefits from investment and on revenue protection also raised concerns for the Committee. The Committee also considered a number of concerns in Post Office, notably around the pension overpayment problems, Financial Services compliance and the SAS70 audit approach for Horizon. There were also updates on compliance across the group, governance structures for taxation issues and the implications of weakening banking covenants;

(c) Remuneration Committee: Orna Ni-Chionna reported on the meeting of the Remuneration Committee of 26 October where there had been a discussion around the targetry for the LTIP. The Committee had noted that whilst the targetry in the plan submitted to the European Commission was more stretching than the management had been comfortable with, the threshold under the scheme was at a lower level than previous schemes so that plan would be adopted for the purposes of the LTIP.

It was noted that the Committee had also reviewed the benchmarking work of executive remuneration that had revealed that whilst there were some issues around remuneration, it was not a particularly widespread problem at most levels.

**RMH11/140** **HEALTH & SAFETY PERFORMANCE - RMH(11)113**

(a) The Board noted the comprehensive Health & Safety Performance summary dated November 2011. The Board noted with sadness that two colleagues had lost their lives in separate recent road accidents. Police reports on both incidents were awaited.

**RMH11/141** **CEO REPORT**

(a) Moya Greene advised the Board that the Shareholder Executive had reported that the case team in Europe had concluded the official advice that £1090m of aid was allowable in response to the Government's submission. The Board noted that whilst this advice would be provided to Commissioner Almunia over the following week, it was not certain whether he would accept the advice nor whether he would be able to secure the agreement of other parties. It was, nonetheless, a major step forward in our state aid case. Moya Greene explained that the aid covered both the pension solution (where the case team had concluded that all but £120m - £150m of the pension deficit was attributable to abnormal costs) and for the balance sheet restructuring. The Board agreed that the balance sheet restructuring element was short of its ideal position but probably sufficient for an investment grade rating. The Board further noted that there had not been any indication of required compensatory measures and congratulated the team, and particularly Sue Whalley, on the progress so far;

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(b) Moya Greene further reported that Ofcom had published a second consultation document. The Board noted that a number of constraints that had previously been applied were proposed to be removed. The price for this had been that Ofcom had requested more extensive reporting and this request had been agreed to on the basis that the information was not to be published. The Board asked the Company to consider adding a condition that the information would be provided to Ofcom only if they used it;

**ACTION: Sue Whalley**

(c) the Board was advised that a programme of public relations with customers was being developed for the following year in order to help customers understand why the Company is having to take the action that it is doing.

**RMH11/142 PENSIONS GOVERNANCE - RMH(11)114**

(a) The Chairman advised the Board that in his meeting, Dave Ward had raised a view that employees looked to the CWU to protect their pension more than they looked to the Trustee. He had also expressed a view that colleagues were unaware of the implications of the pension solution;

(b) Jon Millidge explained that the Trustee Board of RMPP was scheduled to experience a number of changes of personnel over the forthcoming months and that this coincided with the implementation of the pension solution and discussions on future contribution rates and investment strategy. The Board agreed to the proposals in the paper to extend the terms of office of Jonathan Evans, Alwen Lyons, Martin Gafsen and Law Debenture by varying periods to ensure a more manageable change of trustee directors in future.

**ACTION: Jon Millidge**

The Board agreed that the current RMSEPP employer nominated trustees would be replaced at the end of their period of office by representatives who are not members of the scheme. The Board noted that there was no suggestion that any of the current trustees had managed any conflicts inappropriately.

**ACTION: Jon Millidge**

The Board noted that John Duncan had recently been appointed as a trustee of RMSEPP and would resign from the Pensions Committee but would attend wherever appropriate;

(c) Jon Millidge reminded the Board that the original pension solution proposed by Government had left the risk of pensionable pay increases above the CPI level with the RMPP (and therefore ultimately with the Company). This would be fully funded with assets which, at the time were estimated to be about £1.5bn to £2bn. Since then market conditions had changed and the liabilities on that basis would have increased by about £2bn, leaving Government with a requirement to leave with the RMPP around £4bn. of assets to match those liabilities. This had resulted in the Government revisiting its proposal and they now proposed to leave the fund with just the risk of pay inflation above RPI. This was expected to bring the liabilities (and assets required to match them) back down to around £2bn. This was attractive to the Company because of the reduction in volatility but there was an arguable legal case that this went beyond the powers that the Government had, and there was a small risk that a member or other party could take action against the scheme. The Company had sought from Government a commitment that if, as a result of a successful legal challenge, the RMPP were left with more liabilities than the parties intended then the Government would return assets of an equivalent value so as to make the liabilities fully funded as at the cut-off date. The Government had been reluctant to give a binding commitment of that nature.

The Board considered the risk and concluded that:

i. whilst the risk of a claim was small, the potential consequences of a successful claim were substantial;
ii. any risk such as this would have to be disclosed to potential investors and could damage the prospects of a successful transaction;
iii. the risk of a successful claim needed to be offset against the volatility of additional liabilities;
iv. that the risk needed to be looked at in the context of a potential insolvency situation;
v. that the Government could choose to implement whatever arrangements it wished in relation to this issue.

**ACTION: Jon Millidge**

The Board asked Jon Millidge to continue to push for the best possible assurance from Government and devolved the decision to the Pensions Committee, adding that the Company Secretary should circulate the relevant papers to all Board members. The Board further agreed that the Pensions Committee be authorised to approve any statutory instruments or other documents required for the effecting of the pensions solution;

(d) Frank Schinella explained to the Board that the current plan had assumed an increase in contributions for future accrual in RMPP up to 18.3%. Since the plan had been signed off and submitted to the European Commission, market conditions had worsened and there was a risk that the poor return on bond yields could drive this contribution rate up significantly by the time the negotiation with the Trustee on future contribution commenced in earnest. The Board noted this position and that there were a range of options which would be discussed later in the meeting which would be aimed at bringing the plan back into balance;

(e) the Board then considered the risk of RMPP returning into deficit and noted that under the current investment strategy, there was a 5% chance of a deficit of c£1.5bn arising in any one year but that through hedging at a relatively low cost, this could be brought down to a 5% risk of a deficit of about £0.5bn arising over the period to March 2015. The Board noted this position and that this would be used as the initial assumption in discussion with the Trustee, but agreed that a final decision would have to be made in

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the understanding of future plans for pension benefits;

(f) Jon Millidge explained that the Company had been reviewing options of how to deal with the change in investment market conditions and how that may affect the future funding costs. Given that the Company could not seek any further funding from Government, the Board noted that the Company would be required to resolve the issues itself to keep its current plan whole should such a change in funding costs arise. In that context, the Company had taken the precaution of looking at a number of options that would limit cost of future accrual. These options had included:
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i. closing to future accrual. The Board understood that this would have significant cost benefits but that there was likely to be major industrial action as a result which would certainly have an impact on the revenue performance of the Company and would slow the modernisation progress;
ii. reducing the career salary accrual rate. This would produce lower savings but would probably result in industrial action;
iii. changing the rules of the scheme so that pensionable pay would increase in line with the retail price index. This would have some benefits to employees during periods of pay restraint and would produce sufficient funds in the RMPP to allow an investment strategy more in line with normal practice. The Board was concerned about the potential impact on people being promoted and asked that options be drawn up to be presented to the Board.

**ACTION: Jon Millidge**

The Board expressed confidence in its overall plan that had been submitted to the European Commission but recognised that the Company would have to plan for contingencies to ensure that the plan remained achievable and would succeed in restoring the Company to viability. The Board asked that the third option above be developed further in case such action was needed;

**ACTION: Jon Millidge**

(g) Jon Millidge explained that the trustees of RMSEPP had received legal advice that pensions in payment for some members should be increased at RPI rather than CPI (which is the level that the Company believes the increases should be made at). Whilst they had agreed to continue to operate increases at CPI, this would only be for a limited period and the Company had commenced proceedings to have the issue tested in court. The Board noted that the case was far from clear but given that Section B members of RMPP would have their increases at CPI, it was important that the Company should challenge the Trustees of the senior executive scheme on this issue.

The Board noted that the consultation on changes to future accrual in RMSEPP had concluded and noted that decisions on the future accrual of that scheme would be taken by the Remuneration Committee.

**RMH11/143** **OPERATIONS & MODERNISATION REPORT - RMH(11)115**

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(a) Mark Higson advised the Board that the Christmas operation was proceeding in line with expectations. There had been some resourcing problems for temporary resources as a result of moving to a new model for Christmas recruitment and this would be investigated but the issue was severe in some areas. The Board was also advised that nine packet sort centres had been established for the operation this year which would give some added strengthening to the operational plan. Mark Higson advised the Board that October had seen the highest number of delivery revisions being implemented and that there had been no measurable adverse impact on quality in the November period;

(b) Moya Greene explained that when the plan was constructed there was a good understanding that mail volumes would decline and this would be offset to some degree by an increase in parcel volumes. It had been understood that parcels would take longer to be delivered than letters but the initial view of the difference was proving to be inaccurate;

(c) the Board noted that the overall performance of the operations area was roughly in line with budget even though volumes were higher by 5.1% for letters against the budget. Packets were also up against last year (3.2%) and budget (4.5%) and this was having a significant impact on our ability to reduce costs;

(d) the Board noted that the budgeted impact of volume decline was that £64m of costs could be saved. However, due to the higher than Budgeted volumes of Letters and Packets and the improved understanding of cost drivers, it is now understood there is a maximum saving opportunity of £19m. The Board noted that this assumption was the result of current work in progress (looking at disaggregating the activities in the pipeline and by adding in the costs of new activities such as scanning), and that the figures and industrial engineering values would be updated as the work progressed on this. The Board further noted that the figures would be independently verified by external specialists;

(e) Mark Higson advised the Board that the efficiency and technical changes were in line with expectations;

(f) the Chairman reported that Dave Ward had expressed a view that the Company was not taking sufficient action to communicate to people why change had to happen in the way that it was being done;

(g) the Board noted that whilst there was some significant progress on implementing revisions, there was some substantial opposition at both national and local level from the CWU. Moya Greene advised that much work would have to be done to ensure that consultation with the CWU became more systematic. She further advised that she had engaged in discussions with the CWU about the possibility of a long term arrangement to secure change which would have a no strike deal at its centre;

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(h) the Board noted the revised approach to delivery flow and the decision to focus activity on the larger offices. The consequence would be that the plan would be slower to implement but with the larger offices implemented on time.

**RMH11/144** **FINANCE DIRECTOR'S REPORT - RMH(11)116-122**

(a) The Board noted the Period 8 report and that the profit of £43m was in line with budget. Although revenue was £19m below budget, this was offset by a favourable cost variance. The Board further noted that the YTD cash inflow had increased to £434m over the month;

(b) Matthew Lester advised the Board that the full year operating profit was forecast to be at £449m (budget £310m) but the Autumn and Christmas trading results would be critical to this performance;

(c) the Board discussed at length the financial circumstances of the Company and, in particular the improved cash position. Given what the Board had heard earlier in the meeting about the positive response from the European Commission to the State Aid submission, the Board concluded that the Company remained a going concern. The Board agreed to review the position at its next meeting;

**ACTION: Matthew Lester**

(d) Paula Vennells updated the Board on the major issues within Post Office Ltd. The Board noted that financial performance remained ahead of target and that POL and RMG had committed to work together to exploit the Collections and Returns market. The Board asked that the two teams present their progress on the plan at the meeting in February. The Board noted that the recent Horizon failure had disrupted service on one of the busiest days of the year but that the cause of the system failure had been identified and the system is now stable. Paula Vennells advised the Board of the dissatisfaction within POL of the recent report from Consumer Focus. The Board advised that the Cabinet Office be copied in on correspondence with Consumer Focus.

**ACTION: Moya Greene / Paula Vennells**

**ACTION: Paula Vennells**

(e) Rico Back advised that Christmas performance was improving slightly over recent weeks for GLS compared with earlier in the autumn, and that the competition had followed GLS on price increases. Nonetheless, trading conditions remained challenging. The Board was advised that GLS France had now successfully disposed of its In – Night business. Rico Back noted three big challenges over the forthcoming year:

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i. the general economic position in the Eurozone remained very uncertain;
ii. there is a move in Germany to try to ensure that subcontractors are unionised to the same extent as direct employees;
iii. there is a substantial reduction in the number of working days in Germany in 2012/13;

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(f) the Board noted the Commercial and Consumer and Network Access Reports.

**RMH11/145** **FINANCIAL RESTRUCTURING – RMH(11)123**

(a) The Board noted Matthew Lester's paper and that:

i. RMG currently has negative distributable reserves of £8.4bn and that the pension solution would reduce this by about half. Thus RMG would still have £4.2bn of negative distributable reserves and be un-investable;

ii. various solutions to the problem had been evaluated and it was proposed that a Topco be created which could acquire RMG in return for the issue of shares, thus enabling Topco to be able to have distributable reserves. The deficit of distributable reserves at RMG level would also be addressed through a reduction in capital, allowing RMG to distribute reserves to Topco;

**ACTION:**

iii. there are two methods which would allow for the reduction in capital, and both of these methods are intended to ensure that reserves are not distributed to the detriment of creditors. The methods are either through High Court approval or by a solvency statement from the Directors to the effect that they believe that the Company will be able to pay its debts for a period of 12 months from the solvency statement. The Board agreed that the use of a solvency statement was the preferred option;

(b) The Board noted that the timing of a solvency statement was still to be decided but noted that it could be made at the year end following the pensions solution and rely on the same diligence that provides comfort that the accounts can be produced on a going concern basis. The alternate timing was immediately preceding a transaction and the Board noted that it would not be proceeding with a transaction if it did not feel able to make such a solvency statement.

***Secretary's Note: Paula Vennells left the Board at this point as she was conflicted regarding item RMH11/146 and it was noted that Les Owen was expected to resign from the Post Office Ltd Board shortly was excluded at POL Board meetings from items relevant to RMG and since negotiations on substantive issues had been concluded he was not conflicted.***

**RMH11/146** **POL SEPARATION REPORT**

(a) A separate minute was produced for this item.

**RMH11/147** **ANNUAL SECURITY REPORT RMH(11)124**

**ACTION: Jon Millidge**

(a) The Board noted the report and asked that Tony Marsh attend the next Board meeting to provide an update. The Board asked for an update on progress in Special Delivery issues recognising that the

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ARC is looking at the issue also. The Board asked that it be made clear where issues were being dealt with by Internal Audit.

**RMH11/148** **COMPANY SECRETARY'S REPORT- RMH(11)125**

(a) The Board noted the report.

**RMH11/149** **GROUP REGULATION UPDATE – RMH(11)126**

(a) The Board noted the report.

**RMH11/150** **CLOSE**

**ACTION: Jon Millidge**

(a) The Board expressed approval of the summary sheets for Board papers and asked that they continue with some modification. They also asked the Company Secretary to provide a guide to iPad use;

(b) the Chairman thanked Jeff Triggs for his service as interim General Counsel over the previous year;

(c) in the absence of any further business, the Chairman closed the meeting. The next meeting of the Board was scheduled for the 8th February 2012, at 100 Victoria Embankment, London.

**RMH11/146** **POL SEPARATION**

(a) Mark Thomson advised the Board that good progress had been made on the substantive issues and all had been resolved satisfactorily. There were some minor issues still to be covered and final drafting would take place over the next few weeks;

(b) the Board noted that since their last meeting, the main principles of the Mails Distribution Agreement had been unchanged with the exception of:

i. POL would offer exclusivity to all RMG products including Collections and Returns;
ii. should exclusivity fall away RMG could give POL 12 months notice of termination and there would be no stranded costs payable by RMG to Post Office Ltd;
iii. the opening hours and size of the POL network was now covered in the contract;

(c) the Board noted that there had only been minor changes to the Master Services Agreement, notably that the stranded costs would be shared after the first £15m (which would fall to RMG in line with its plan);

(d) Jon Millidge advised the Board that properties occupied by POL would transfer at nil cost, but that the rental income that RMG would have received from POL would be recovered by way of an offset against the charge on the Mails Distribution Agreement. This would reduce after 4 years. POL occupied properties which form a

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valuable part of a much bigger property (eg Mt Pleasant) would not transfer;

(e) the Board congratulated Mark Thomson and colleagues on a successful outcome, and authorised the executive team to sign the agreements and terminate the current Inter Business Agreement.