

Funding Agreement
EXECUTION VERSION

25 October 2010

THE SECRETARY OF STATE FOR BUSINESS, INNOVATION & SKILLS

POST OFFICE LIMITED

ROYAL MAIL HOLDINGS PLC

ROYAL MAIL GROUP LIMITED

FUNDING AGREEMENT

CONTENTS

CLAUSE	PAGE
1. INTERPRETATION.....	1
2. CONDITIONS	4
3. DELAYED PAYMENT	6
4. STATE AID CLEARANCES.....	6
5. GOVERNMENT FUNDING FOR SERVICES OF GENERAL ECONOMIC INTEREST	6
6. POL STRATEGIC PLAN.....	10
7. MAILS' ACKNOWLEDGMENT.....	10
8. HOLDINGS' ACKNOWLEDGMENT.....	10
9. FINAL CONTRIBUTION.....	10
10. EMPLOYEE INCENTIVE ARRANGEMENTS.....	11
11. SUB-POSTMASTER COMPENSATION CONDITIONS.....	11
12. ACCESS CRITERIA	11
13. JOINT VENTURES.....	12
14. SEPARATION EVENTS	13
15. PUBLIC CONSULTATION, COMMUNICATION AND EQUALITY.....	13
16. CONSENTS.....	13
17. CONFIDENTIALITY.....	13
18. NOTICES.....	14
19. ENTIRE AGREEMENT.....	15
20. GENERAL	16
SCHEDULE 1 DELIVERABLES.....	19
SCHEDULE 2.....	20
PART A FUNDAMENTAL CHANGE	20
PART B POTENTIAL FUNDAMENTAL CHANGE.....	20
SCHEDULE 3 CALCULATION OF SGEI PAYMENT.....	21
APPENDIX A POL ENTRUSTMENT LETTER.....	22
APPENDIX B STRATEGIC PLAN.....	27

THIS AGREEMENT is made on 25 October 2010

BETWEEN:

- (1) **THE SECRETARY OF STATE FOR BUSINESS, INNOVATION & SKILLS** of 1 Victoria Street, London SW1H 0ET (the *Secretary of State*);
- (2) **POST OFFICE LIMITED**, a company incorporated in England and Wales (registered number 2154540) and whose registered address is 148 Old Street, London EC1V 9HQ (*POL*);
- (3) **ROYAL MAIL HOLDINGS PLC**, a company incorporated in England and Wales (registered number 4074919) and whose registered address is 100 Victoria Embankment, London EC4Y 0HQ (*Holdings*); and
- (4) **ROYAL MAIL GROUP LIMITED**, a company incorporated in England and Wales (registered number 4138203) and whose registered address is 100 Victoria Embankment, London EC4Y 0HQ (*Mails*).

WHEREAS:

(A) All of the issued share capital of Holdings is currently beneficially owned by the Government, all of the issued share capital of Mails is currently beneficially owned by Holdings and all of the issued share capital of POL is currently beneficially owned by Mails.

(B) The Secretary of State has requested POL to continue to provide a national network of post office Branches across the United Kingdom and wishes to entrust to POL the provision of certain services of general economic interest over that network.

(C) The Secretary of State has agreed to enter into this Agreement in order to provide funding to POL to enable it to continue to provide services of general economic interest across that national network.

(D) It is acknowledged by the Parties that POL will not have achieved a full conversion to variable pay agency contracts in respect of all sub-postmasters before the conclusion of the Funding Period, and as such, it is envisaged that further funding may be required to complete this process for the Financial Years 2015/16 and 2016/17.

(E) It is acknowledged by the Parties that the Postal Services Bill (as introduced in the House of Commons on 13 October 2010) contemplates the restructuring of the Royal Mail Group, and in particular makes provision for the separation of POL from the Royal Mail Group, and potential move to mutual ownership of POL. Accordingly, the parties acknowledge that certain obligations of Mails or Holdings pursuant to this Agreement shall no longer have effect upon POL ceasing to be a wholly-owned subsidiary of that Party.

NOW THIS AGREEMENT WITNESSES as follows:

1. INTERPRETATION

1.1 In this Agreement, including the recitals, Schedules and Appendices, unless the context requires otherwise:

Act means the Postal Services Act 2000.

Branch means any retail outlet of POL, including any post office counter at a retail outlet and any other facility (including an “outreach” facility) designated for the transaction of business with members of the public by or on behalf of POL.

Business Day means a day (not being a Saturday or a Sunday) on which banks are open for general non-automated banking business in the City of London.

Code of Practice means the Code of Practice on Public Consultation and Communication with respect to change in the post office network introduced on 1 April 2009 as amended, varied, supplemented or substituted from time to time.

Cumulative SGEI Statement has the meaning given to it in clause 5.10 ((*Government Funding for Services of General Economic Interest*)).

Deprived Urban Areas means:

- (a) the most deprived fifteen per cent. (15%) of super output areas in England;
- (b) the most deprived fifteen per cent. (15%) of data zones in Scotland; and
- (c) the most deprived thirty per cent. (30%) of super output areas in Wales and Northern Ireland,

based upon each country’s then current index of multiple deprivation.

Entrustment Letter means the letter in the form set out at Appendix A (*POL Entrustment Letter*) from the Secretary of State to POL and countersigned by POL.

Financial Year means an accounting period of POL commencing on or around 1 April in any calendar year and ending on or around 31 March in the following calendar year.

Fundamental Change means the occurrence of any of the events listed in Part A of Schedule 2 (*Fundamental Change*).

Funding Period means the period from 31 March 2012 until 29 March 2015.

GCA Contract means the agreement dated 5 March 2009 between POL and the Secretary of State for Work and Pensions for the provision of Government Card Account Services.

Government means Her Majesty’s Government.

Milestone means:

- (a) in respect of the SGEI Payment payable on 1 April 2012 (or the first Business Day thereafter), the requirements referred to as Milestone 1;
- (b) in respect of the SGEI Payment payable on 1 April 2013 (or the first Business Day thereafter), the requirements referred to as Milestone 2; and
- (c) in respect of the SGEI Payment payable on 1 April 2014 (or the first Business Day thereafter), the requirements referred to as Milestone 3,

in each case in Part 2 section 4A (*Milestones and Milestone Test Dates*) of the Strategic Plan.

Milestone Test Date means, in respect of each SGEI Payment, the date specified in Part 2 section 4A (*Milestones and Milestone Test Dates*) of the Strategic Plan for the achievement of the Milestone applicable to that SGEI Payment.

Order means the Post Office Network Subsidy Scheme Order 2007 (SI 2007/962) made pursuant to section 103 of the Act as may be amended or replaced by any subsequent payment order increasing the maximum amount payable under it in any twelve (12) month period.

Parties means the parties to this Agreement.

POL Working Capital Facility means the £1,150,000,000 working capital facility provided to POL pursuant to the terms of the credit facilities agreement between the Secretary of State and POL dated 17 October 2003, as amended and restated on 16 May 2007, amended on 18 April 2008 and further amended and restated on 24 March 2010.

Potential Fundamental Change has the meaning given to it in Part B of Schedule 2 (*Potential Fundamental Change*).

Relevant Payment has the meaning given to it in clause 3 (*Delayed payment*).

Remedy Period has the meaning given to it in clause 3 (*Delayed payment*).

Required Payment Date has the meaning given to it in clause 3 (*Delayed payment*).

Royal Mail Group means Holdings and each of its subsidiaries.

Rural Areas means those communities which are not Urban Areas.

Separation Event means any event by virtue of which POL ceases to be: (i) a wholly-owned subsidiary of Mails; or (ii) a wholly-owned subsidiary of Holdings.

SGEI Payment means a payment by the Secretary of State in a Financial Year of an amount calculated in accordance with Schedule 3 (*Calculation of SGEI Payment*) to compensate POL for the net cost of: (i) maintaining a network of post offices in accordance with clause 12 (*Access Criteria*); and (ii) ensuring the provision of services of general economic interest over that network, in each case during that Financial Year.

SGEI Statement has the meaning given to it in clause 5.10 (*Government Funding for Services of General Economic Interest*).

SGEI Supporting Statement has the meaning given to it in clause 5.10 (*Government Funding for Services of General Economic Interest*).

State Aid Clearance means, in respect of any payment to be made to POL under this Agreement, confirmation by the European Commission that such payment is compatible with the requirements on state aid of the Treaty on the functioning of the European Union.

Strategic Plan means POL's strategic plan in relation to the provision of services of general economic interest as set out in Appendix B (*Strategic Plan*);

Urban Areas means communities with ten thousand (10,000) or more inhabitants in a continuous built up area.

VAT Amount has the meaning given to it in clause 5.13 (*Government Funding for Services of General Economic Interest*).

1.2 In this Agreement, except where the context otherwise requires:

- (a) a reference to a person (which shall include any individual, firm, company, corporation or other body corporate, government, state or agency or any association, trust, fund or partnership (whether or not having separate legal personality) shall include, as appropriate, its successors, permitted assignees or transferees;
- (b) a reference to an enactment or statutory provision shall include a reference to any subordinate legislation made under that enactment or statutory provision and is a reference to that enactment, statutory provision or subordinate legislation as from time to time amended, consolidated, modified, or re-enacted;
- (c) words in the singular shall include the plural and vice versa;
- (d) references to one gender include other genders;
- (e) a reference to any agreement or other instrument (other than an enactment or statutory provision) shall be deemed to be a reference to that agreement or instrument as from time to time amended, varied, supplemented, substituted, novated, assigned or restated;
- (f) a reference to a clause or Schedule shall be a reference to a clause of, or Schedule to, this Agreement;
- (g) a reference to “includes” or “including” shall be construed without limitation to any events, circumstances, conditions, acts or matters specified after those words;
- (h) references to dates which do not fall on a Business Day shall be construed as references to the immediately subsequent Business Day;
- (i) the headings are for convenience only and shall not affect its interpretation; and
- (j) references to this Agreement include this Agreement as amended or supplemented.

1.3 The Schedules and Appendices form part of this Agreement and shall have the same force and effect as if expressly set out in this Agreement, and any reference to this Agreement shall include the Schedules and Appendices.

2. CONDITIONS

2.1 The obligation of the Secretary of State under this Agreement to make any SGEI Payment is conditional on:

- (a) all necessary State Aid Clearances having been obtained for the making of that payment; and
- (b) the Milestone having been achieved.

2.2 Each obligation of POL, Holdings and Mails under clauses 5 (*Government Funding for Services of General Economic Interest*), 6 (*POL Strategic Plan*), 7 (*Mails' acknowledgement*), 8 (*Holdings' acknowledgement*), 12 (*Access Criteria*) and 15 (*Public*

Consultation, Communication and Equality) of this Agreement, and the obligations of POL under the Entrustment Letter, in each case in each of Financial Years 2012/13, 2013/14 and 2014/15 (respectively), is conditional on the conditions referred to in clause 2.1 having been met in respect of the SGEI Payment for that Financial Year, save that to the extent the condition in clause 2.1(b) is not met and (at the absolute discretion of the Secretary of State) only part of the SGEI Payment for that Financial Year is paid, then POL shall perform such of its obligations under this Agreement and the Entrustment Letter as shall be determined by POL and the Secretary of State to be appropriate having regard to the funding constraints to which POL will be subject and to POL's obligations under clause 6.1 (*POL Strategic Plan*).

2.3 In the event that POL fails to achieve any Milestone by the Milestone Test Date, the Secretary of State shall have no obligation to make the SGEI Payment until POL has achieved the Milestone. Should POL not achieve the Milestone within 3 months following the Milestone Test Date, any payment (or part thereof) by the Secretary of State of the SGEI Payment shall be at the absolute discretion of the Secretary of State.

Deliverables

2.4 On the date of this Agreement, POL, Mails and Holdings shall deliver (or ensure that there is delivered) all those documents listed in Schedule 1 (*Deliverables*) in a form and substance satisfactory to the Secretary of State (acting reasonably).

Fundamental Change

2.5 Without prejudice to the accrued rights and remedies of the Parties, the obligations of the Secretary of State to make or facilitate any payments in accordance with this Agreement, the obligations of POL, Holdings and Mails under clauses 5 (*Government Funding for Services of General Economic Interest*), 7 (*Mails' acknowledgement*), 8 (*Holdings' acknowledgement*), 12 (*Access Criteria*) and 15 (*Public Consultation, Communication and Equality*) of this Agreement and the obligations of POL under the Entrustment Letter, shall immediately terminate upon the occurrence of a Fundamental Change.

2.6 If on the date on which any payment is due to be made by the Secretary of State to POL under this Agreement a Potential Fundamental Change exists, the Secretary of State shall be entitled to withhold such payment until such time as:

- (a) a Fundamental Change occurs, whereupon clause 2.5 shall apply and the Secretary of State shall have no obligation to make that payment; or
- (b) the Potential Fundamental Change ceases to exist, whereupon the payment shall become immediately due and payable, together with interest from the due date until the date of actual payment at a rate equivalent to the rate of interest then applicable to drawings by POL under the POL Working Capital Facility (as amended from time to time).

2.7 Until the date on which the last SGEI Payment is due to be made by the Secretary of State to POL under this Agreement, POL shall promptly disclose to the Secretary of State any matter or thing of which its board of directors becomes aware after entering into this Agreement which constitutes, or which in the reasonable opinion of its board of directors is reasonably likely to give rise to, a Fundamental Change or a Potential Fundamental Change.

3. DELAYED PAYMENT

If any SGEI Payment to be made by the Secretary of State to POL under this Agreement (a *Relevant Payment*) is not made on or by the date on which it is required by clause 5.6 (*Government Funding for Services of General Economic Interest*) to be made (the *Required Payment Date*), then during the period between the Required Payment Date and the end of the tenth (10th) Business Day thereafter (such period being the *Remedy Period*), the Parties shall continue to comply with their respective obligations under this Agreement and the Secretary of State shall make the Relevant Payment within the Remedy Period.

4. STATE AID CLEARANCES

4.1 The Secretary of State agrees to:

- (a) prepare as soon as reasonably practicable, in consultation with Mails and POL, an application for State Aid Clearance for all arrangements under this Agreement requiring such State Aid Clearance, including any payments to POL under clause 5 (*Government Funding for Services of General Economic Interest*), in respect of each of the Financial Years 2012/13, 2013/14 and 2014/15.
- (b) pursue such State Aid Clearance application in good faith and expeditiously;
- (c) keep Mails and POL informed as to the progress of such State Aid Clearance application;
- (d) permit representatives appointed by POL to attend meetings with the European Commission in respect of such application, to the extent permitted by the European Commission and deemed appropriate by the Secretary of State;
- (e) discuss with POL any written notifications to the European Commission in respect of such State Aid Clearance application before they are submitted; and
- (f) discuss with POL any written notifications from the European Commission in respect of such State Aid Clearance application promptly upon their receipt.

4.2 As at the date of this Agreement the Secretary of State is targeting the obtaining of the State Aid Clearance referred to in clause 4.1 by 31 March 2012 and the Parties shall use their reasonable endeavours to obtain the State Aid Clearance by such date, it being acknowledged that a mere failure to achieve that target is not of itself a breach of this clause 4.2.

5. GOVERNMENT FUNDING FOR SERVICES OF GENERAL ECONOMIC INTEREST

5.1 POL undertakes to the Secretary of State that it will for the duration of the Funding Period: (i) maintain a network of post offices in accordance with clause 12 (*Access Criteria*); and (ii) provide across that network the services of general economic interest entrusted to it by the Entrustment Letter.

5.2 Subject to clause 2.1 (*Conditions*), the Secretary of State agrees to make to POL in each of the Financial Years 2012/13, 2013/14 and 2014/15 a SGEI Payment in the amount specified in clause 5.6 to enable POL to maintain the network and to provide services of general economic interest over the network.

5.3 The SGEI Payment for each of the Financial Years 2012/13, 2013/14 and 2014/15 shall be made in a manner or manners to be determined by the Secretary of State in his absolute discretion (but having consulted with Holdings, Mails and POL as to the impact thereof (if any) on their profit and loss accounts and the tax treatment of such payments).

5.4 The Secretary of State agrees:

- (a) to submit for approval of both Houses of Parliament as soon as reasonably practicable any order amending or replacing the Order to increase the maximum amount payable under the Order in any period of twelve (12) months in order to make any payment under this Agreement which it is determined by the Secretary of State in accordance with clause 5.3 will be made pursuant to section 103 of the Act;
- (b) to submit for approval of the House of Commons as soon as reasonably, practicable any payment under this Agreement which it is determined by the Secretary of State in accordance with clause 5.3 will be made pursuant to section 8 of the Industrial Development Act 1982;
- (c) to keep Mails and POL informed as to the progress of such approval(s); and
- (d) to notify Mails and POL in writing as soon as reasonably practicable after such approval(s) have been obtained.

5.5 If and to the extent that the Secretary of State determines to make any part of any SGEI Payment by way of paying such amount to Holdings or Mails for the purpose of its being applied in subscription for shares in POL, any such payment to Mails or Holdings shall be held by Mails or Holdings, as applicable, upon trust to apply it immediately for the purpose for which it was paid.

5.6 The amount of the SGEI Payment payable in each of the Financial Years 2012/13, 2013/14 and 2014/15 shall be calculated in accordance with Schedule 3 (*Calculation of SGEI Payment*), but subject always to the aggregate amount of all SGEI Payments during the Funding Period not exceeding one billion one hundred and fifty-five million pounds (£1,155,000,000). Each SGEI Payment shall be made by way of payment on 1 April (or the first Business Day thereafter) of the relevant Financial Year of the amount specified in clause 5.7 (subject to adjustment in accordance with clause 5.11).

5.7 The amount payable on account of the SGEI Payment (subject to reconciliation in accordance with clause 5.10) in:

- (a) the Financial Year 2012/13 shall be four hundred and ten million pounds (£410,000,000);
- (b) the Financial Year 2013/14 shall be four hundred and fifteen million pounds (£415,000,000); and
- (c) the Financial Year 2014/15 shall be three hundred and thirty million pounds (£330,000,000).

In ascertaining for any purpose of this clause 5 the amount or maximum amount of any SGEI Payment no account shall be taken of: (i) any VAT Amount which may be payable under clause 5.13; or (ii) the benefit of any interest receivable on any amount held by POL prior to its expenditure.

5.8 The Secretary of State acknowledges that, without prejudicing his discretion to determine the method of payment of the SGEI Payment referred to in clause 5.3 above, it is his current expectation that:

- (a) two hundred and ten million pounds (£210,000,000) of the SGEI Payment for Financial Year 2012/13;
- (b) two hundred million pounds (£200,000,000) of the SGEI Payment for Financial Year 2013/14; and
- (c) one hundred and sixty million pounds (£160,000,000) of the SGEI Payment for Financial Year 2014/15

will be made by way of a payment under a network subsidy scheme introduced under the Order provided that: (i) the necessary statutory instrument to permit such payment has been approved by an affirmative resolution of each House of Parliament; and (ii) any necessary consent to the making of such statutory instrument has been given by the Lords Commissioners of Her Majesty's Treasury.

5.9 It is acknowledged by the Parties that any part of the SGEI Payments received by POL under a network subsidy scheme pursuant to section 103 of the Act (currently expected to be the amounts specified in clause 5.8 above) would be treated as revenue in POL's accounts, which has an impact on POL's operating profit. Should any SGEI Payment (or part thereof) be made in any Financial Year in any manner which would result in it not being treated as revenue in POL's accounts then any target operating profit applicable for any purpose to POL or, prior to a Separation Event, the Royal Mail Group as a whole in such Financial Year shall be reduced by the amount of any SGEI Payment (or part thereof) received in any such manner in that Financial Year.

5.10 Within three months following the signature of POL's accounts in respect of each of the Financial Years 2012/13, 2013/14 and 2014/15, POL shall provide to the Secretary of State a statement (the *SGEI Statement*) setting out in writing the actual amount of the SGEI Payment for that Financial Year and a cumulative statement (the *Cumulative SGEI Statement*) setting out the cumulative amount of the SGEI Payments from the commencement of the Funding Period, together with supporting calculations and a clear explanation of how the actual amount of the SGEI Payment has been calculated. Each SGEI Statement shall be accompanied by a statement (the *SGEI Supporting Statement*) from an independent firm of financial advisers confirming:

- (a) that the SGEI Statement has been properly prepared in accordance with the requirements of Schedule 3 (*Calculation of SGEI Payment*) and any additional conditions imposed by any relevant State Aid Clearance; and
- (b) that while carrying out its financial analysis for the purposes of providing the statement referred to in paragraph (a) above, they did not discover any inconsistency of POL's use of the SGEI Payments as against the terms of this Agreement or of any applicable State Aid Clearance.

For the avoidance of doubt, the independent firm of financial advisers will not be responsible for determining whether the allocation of costs in paragraph 3 of Schedule 3 (*Calculation of SGEI Payment*) is appropriate or whether the profit in paragraph 4 of Schedule 3 (*Calculation of SGEI Payment*) is reasonable. POL agrees to use reasonable endeavours to engage such independent firm of financial advisers on the basis that, if requested by the Secretary of State and on such terms as the financial advisers may agree:

- (c) an accountancy firm nominated by the Secretary of State shall be entitled to discuss directly with the financial advisers the manner in which the SGEI Supporting Statement has been prepared; and
- (d) the financial advisers shall provide to the Secretary of State all notes and other work products produced by them in the preparation of the SGEI Supporting Statement.

5.11 If following the end of the Funding Period the Cumulative SGEI Statement in respect of Financial Years 2012/13, 2013/14 and 2014/15 shows that the aggregate actual amount of the SGEI Payments over the Funding Period is less than one billion one hundred and fifty-five million pounds (£1,155,000,000) POL shall, within ten (10) Business Days of receipt by the Secretary of State of the Cumulative SGEI Statement referred to in clause 5.10, reimburse to the Secretary of State, without deduction, an amount equal to the difference.

5.12 POL shall use each SGEI Payment only to meet the direct and indirect costs associated with: (i) maintaining a network of post offices in accordance with clause 12 (*Access Criteria*); and (ii) ensuring the provision of services of general economic interest over that network (as entrusted to it pursuant to the Entrustment Letter), as described in Schedule 3 (*Calculation of SGEI Payment*) (or to make any reimbursement required to be made by POL pursuant to clause 5.11) and only for purposes permitted by any State Aid Clearance applicable to it.

5.13 It is the mutual opinion of the Parties that the SGEI Payments received by POL will not (and POL agrees not to take any steps with the intention of procuring that they will) constitute, for VAT purposes, the consideration for any taxable supply and that, accordingly, the receipt by POL of such SGEI Payments should not give rise to any liability of POL (or any other member of the Royal Mail Group) to account for VAT in respect of any such receipt. Notwithstanding the foregoing opinion, if it should, at any time (whether or not a time falling within the duration of this Agreement), be determined by Her Majesty's Revenue and Customs that such SGEI Payments (or any of them) must be treated as the consideration for taxable supplies made by POL (or, as the case may be, by any other member of the Royal Mail Group) and that in consequence POL (or such other member of the Royal Mail Group) is liable to account for VAT in respect of the receipt of any of such SGEI Payments (the *VAT Amount*), POL shall notify the Secretary of State of that determination within five (5) Business Days of being so advised by Her Majesty's Revenue and Customs and the Secretary of State shall, as soon as reasonably practicable following notification of such determination, make a payment to POL, in addition to all amounts otherwise payable by the Secretary of State to POL under this Agreement, of a sum equal to the VAT Amount, against production of a valid VAT invoice.

5.14 If Her Majesty's Revenue and Customs issues a determination as referred to in clause 5.13, the Parties shall (acting reasonably) consult as to what action to take regarding such determination. If the Secretary of State disagrees with the determination he may, within ten (10) Business Days of being notified by POL of such determination, give written notice to POL that he requires POL (or any other Party) to obtain a review by Her Majesty's Revenue and Customs of that determination; and POL (or such other Party, as the case may be) shall promptly request (the form of that request being subject to reasonable review by the Secretary of State) Her Majesty's Revenue and Customs to undertake such review. In the event that the review results in POL obtaining a refund of any VAT Amount, or not being required to pay a VAT Amount, in each case in respect of which the Secretary of State shall have made a corresponding payment under clause 5.13, POL shall promptly refund to the Secretary of State the amount of such corresponding payment.

5.15 The Secretary of State acknowledges the expectation of the Parties that ongoing SGEI Payments will be required to be made to POL following the end of the Funding Period to the extent that POL may be requested to continue to provide services of general economic interest following the Funding Period.

6. POL STRATEGIC PLAN

6.1 POL shall from 1 April 2011 use its best endeavours to procure the delivery of the Strategic Plan within the financial parameters of the SGEI Payments provided pursuant to this Agreement and (unless otherwise agreed by the Secretary of State or required by the terms of any State Aid Clearance) POL shall not apply any SGEI Payment for a purpose inconsistent with the Strategic Plan or make any material deviation from the Strategic Plan.

6.2 Until the occurrence of a Separation Event, unless POL and the Secretary of State agree otherwise, POL undertakes in favour of the Secretary of State to apply in the normal course any funds representing an aggregate out-performance of POL's net cashflow over the Funding Period relative to the net cashflow envisaged in POL's financial forecasts within the Strategic Plan to reduce POL's borrowings under the POL Working Capital Facility, subject only to the fiduciary duties of the directors of POL. The Parties acknowledge that following any Separation Event the method of reimbursement will need to be reviewed and potentially amended.

7. MAILS' ACKNOWLEDGMENT

7.1 For so long as POL remains a wholly-owned subsidiary of Mails and Mails remains wholly-owned by the Crown, Mails agrees that it shall (insofar as is lawful and consistent with the fiduciary duties of the directors of Mails in the context of Mails' insolvency and appropriate for a parent company in its position) take all necessary steps, including minimising any downside for POL, and take responsibility for requiring that POL takes all necessary steps, to execute the strategy agreed upon for POL wholly within the financial resources made available to POL by this Agreement.

7.2 For so long as POL remains a wholly-owned subsidiary of Mails and Mails remains wholly-owned by the Crown, in the context of this clause 7, Mails agrees that it will consider in good faith any request to make available to POL inter-company debt facilities, where such request is received from POL or the Secretary of State during the Funding Period.

8. HOLDINGS' ACKNOWLEDGMENT

For so long as POL and Mails remain wholly-owned subsidiaries of Holdings, Holdings acknowledges the steps required to be taken by Mails under clause 7 (*Mails' acknowledgement*) and agrees to take all necessary steps appropriate for a parent company in its position (and acknowledging that Mails is the principal material asset of Holdings) to procure that Mails takes those steps.

9. FINAL CONTRIBUTION

9.1 Mails and POL acknowledge that the SGEI Payments to be provided by the Secretary of State pursuant to this Agreement represent the Secretary of State's final funding contribution in respect of POL's obligations over the Funding Period to: (i) maintain a network of post offices in accordance with clause 12 (*Access Criteria*); and (ii) ensure the provision of services of general economic interest over that network in accordance with the Strategic Plan as entrusted to it by the Entrustment Letter.

10. EMPLOYEE INCENTIVE ARRANGEMENTS

10.1 POL shall develop and implement an incentive scheme, to be approved by the Secretary of State, for its senior executive team in a manner which is designed to ensure, and is consistent with ensuring, the delivery of the Strategic Plan.

10.2 POL confirms that:

- (a) the terms of any bonus arrangements specific to POL (or those parts of any group-wide arrangements which are related to the performance of POL) are designed to incentivise and reward the performance of POL;
- (b) the terms of such bonus arrangements are robust, subject to annual review and designed not to provide rewards where POL's business has not performed satisfactorily against the relevant target; and
- (c) accordingly, no such bonus arrangements will pay out in respect of any Financial Year during the Funding Period in which POL seeks and obtains new funding from the Secretary of State, over and above that anticipated in this Agreement, as a result of a failure by POL to perform in accordance with the requirements of the Strategic Plan (other than as a result of a change in Government policy or other reasons beyond POL's control). Any future bonus arrangements following any such Financial Year will be discussed with the Secretary of State at the time.

11. SUB-POSTMASTER COMPENSATION CONDITIONS

11.1 As part of its obligations to deliver the Strategic Plan, POL shall ensure that it complies with the provisions of clause 12 (*Access Criteria*) and confirms that the Strategic Plan has been developed on the basis that no community loses access to services of the type contemplated in clause 12 (*Access Criteria*) other than due to circumstances beyond POL's control.

11.2 POL shall ensure that as of 1 April 2012 (or such earlier date as may be agreed between the Secretary of State and POL), all new agency contracts entered into between POL and any sub-postmaster shall be on such terms as to ensure that such sub-postmaster has no right to receive: (i) fixed pay; or (ii) any compensation payment for termination of such agency contract (other than in respect of a breach by POL of the terms of such agency contract or applicable law).

11.3 POL shall ensure that (save as required by law or contractual requirements) following 1 April 2012, no compensation payments may be paid to any sub-postmaster upon replacement of such sub-postmaster's existing agency contract, unless such replacement agency contract complies with the provisions of clause 11.2.

12. ACCESS CRITERIA

12.1 Without prejudice to its obligations pursuant to clause 5.1 (*Government Funding for Services of General Economic Interest*), POL shall throughout the Funding Period provide a network of at least eleven thousand, five hundred (11,500) Branches which:

- (a) provide access to all of the following services:
 - (i) postal services;

- (ii) basic cash and banking facilities and services offered in accordance with the GCA Contract;
- (iii) bill payment facilities; and
- (iv) information about other services which may be available from POL outlets from time to time,

provided that a maximum of five hundred (500) Branches (such Branches to be determined by POL in its absolute discretion) shall not be required to provide the service contemplated in clause 12.1(a)(ii) (*Access Criteria*) above; and

- (b) enables the following criteria to be met:
 - (i) **Nationally:**
 - (A) ninety per cent. (90%) of the UK population are within one (1) mile of the nearest Branch;
 - (B) ninety nine per cent. (99%) of the UK population are within three (3) miles of the nearest Branch;
 - (ii) **In Urban Areas:**
 - (A) ninety five per cent. (95%) of the total population within Urban Areas across the UK are within one (1) mile of the nearest Branch;
 - (B) ninety nine per cent. (99%) of the total population within Deprived Urban Areas across the UK are within one (1) mile of the nearest Branch;
 - (iii) **In Rural Areas:** ninety five per cent. (95%) of the total population within Rural Areas across the UK are within three (3) miles of the nearest Branch;
 - (iv) **In each postcode district:** ninety five per cent. (95%) of the population in each individual postcode district are within six (6) miles of the nearest Branch.

12.2 In applying the above criteria POL shall in addition take account of geographical constraints such as rivers, mountains and valleys, motorways and sea crossings to islands so as not to impose undue hardship when considering the appropriate Branch network.

12.3 Reference to “Branch” in this clause 12 shall mean a Branch providing the services described in clause 12.1(a).

13. JOINT VENTURES

13.1 POL agrees that it shall only enter into joint ventures with third parties for purposes consistent with the delivery of the Strategic Plan and provided that the joint venture is structured on the basis that it would not (according to Government advice) be classified as part of the public sector under relevant Treasury rules.

14. SEPARATION EVENTS

14.1 The Secretary of State commits to considering, prior to effecting a Separation Event, the potential impact of such Separation Event on the deliverability of the Strategic Plan.

14.2 No Party (other than the Secretary of State) shall be liable for any breach of this Agreement if such breach would not have occurred but for the occurrence of a Separation Event.

15. PUBLIC CONSULTATION, COMMUNICATION AND EQUALITY

15.1 POL shall at all times comply with the Code of Practice.

15.2 POL acknowledges the commitment recorded in the resolutions made during its board meeting of 21 January 2008 that any individuals taking any decision or exercising any other function on POL's behalf should do so having due regard to the need to observe factors which comprise the statutory equality duties and that appropriate steps be taken to inform all people making decisions or exercising functions on POL's behalf of these equality duties. POL shall ensure that this commitment is maintained in the performance of its obligations under this Agreement.

16. CONSENTS

The Secretary of State hereby consents, for all purposes of the articles of association of Holdings and any other document or arrangement under which its consent or approval is required, and Holdings hereby consents, for all purposes of the articles of association of Mails, to the execution and performance by Holdings, Mails and POL of this Agreement and the documents and arrangements to be entered into pursuant to, or otherwise contemplated by, this Agreement (other than any agreement contemplated in clause 13). Each of the Secretary of State and Holdings agrees that such consents will take effect notwithstanding any failure to comply with any procedural requirements of such articles or other documents in connection with the obtaining of such consents.

17. CONFIDENTIALITY

17.1 Each Party undertakes to each other Party that, subject to clause 17.2, it shall treat as strictly confidential all confidential information. For the purposes of this clause 17, *confidential information* shall mean:

- (a) the provisions of this Agreement, the Entrustment Letter and the Strategic Plan; and
- (b) the negotiations relating to this Agreement, the Entrustment Letter and the Strategic Plan.

17.2 Clause 17.1 shall not prevent the disclosure by a Party of any confidential information:

- (a) to those of its officers (including auditors), employees and agents as it considers have a need for such information in the performance of their respective functions and who shall in each case be made aware by such Party of its obligations under this Agreement and shall be required by such Party to observe the same restrictions on the use of the confidential information as are contained in this clause 17;

- (b) to its professional advisers who are bound to such Party by a duty of confidence which applies to the confidential information disclosed;
- (c) to the extent required by applicable law or by the regulations of any regulatory or supervisory authority to which such Party is subject or pursuant to any order of court or other competent authority or tribunal;
- (d) which shall have entered the public domain or ceased to be confidential other than as a result of a breach by such Party of its obligations under this clause 17;
- (e) which was already known to such Party prior to its disclosure to such Party other than as a result of a breach by such Party of an obligation of confidentiality;
- (f) as such Party, acting reasonably, considers necessary in connection with any investigations, inquiries, or actual or threatened proceedings in connection with Holdings, Mails or POL or any of their respective directors;
- (g) in the case of Holdings, Mails or POL, to the extent that its board of directors acting reasonably, considers disclosure necessary from time to time in its statutory accounts;
- (h) to the extent that the Secretary of State, acting reasonably, considers disclosure necessary from time to time in the published accounts of the Department of Business, Innovation & Skills or Her Majesty's Treasury;
- (i) to the extent required by any Parliamentary obligation;
- (j) to the extent required for the purposes of any examination pursuant to section 6(1) of the National Audit Act 1983 of the economy, efficiency and effectiveness with which the Secretary of State has used his resources;
- (k) to the European Commission for the purposes of obtaining State Aid Clearance; or
- (l) with the prior written consent of the other Parties.

17.3 If a Party becomes required, in circumstances contemplated by clause 17.2(c), (f) or (g) to disclose any confidential information, such Party shall, to the extent permitted by law, give to each other Party such notice of such disclosure as is practicable in the circumstances and shall, to the extent permitted by law and practicable in the circumstances, consult with the other Parties as to the extent of such disclosure.

18. NOTICES

18.1 A notice to be served pursuant to or in connection with this Agreement shall be in writing and, unless otherwise stated, served in person or sent by pre-paid first class post, fax or any electronic method of communication as agreed by the Parties to the relevant Party at its address or fax number set out below, or such other address in England or Wales or fax number notified by it to the other Parties and marked for the attention of the person or department therein specified.

18.2 The address and addressee of each Party at the date of this Agreement are:

Name of Party	Addressee	Address	Fax Number
Secretary of	Legal Director for	1 Victoria Street,	GRO

Funding Agreement
EXECUTION VERSION

Name of Party	Addressee	Address	Fax Number
State	Postal Services	London SW1H 0ET	
Holdings	Company Secretary	100 Victoria Embankment, London EC4Y 0HQ	GRO
Mails	Company Secretary	100 Victoria Embankment, London EC4Y 0HQ	GRO
POL	Company Secretary	148 Old Street, London EC1V 9HQ	GRO

18.3 A notice shall be deemed to be received on the date and time specified below (save that where such notice would otherwise be deemed to be received after 17:00 London time on a particular day, it shall be deemed to have been received at 9:00 London time on the next Business Day):

- (a) in the case of a notice served in person, upon delivery at the address of the addressee;
- (b) in the case of a posted letter, on the second Business Day after posting;
- (c) in the case of a fax, when received in legible form; and
- (d) in the case of any other electronic method of communication agreed by the Parties, when actually received in readable form.

18.4 Each Party undertakes to notify all of the other Parties by notice served in accordance with this clause if the address specified for that Party herein is no longer an appropriate address for the service of notice or if it is desired to substitute any individual addressee of that Party named in clause 18.2.

18.5 In proving service of any notice under or in connection with this Agreement it will be sufficient to prove:

- (a) in the case of a letter, that such letter was properly stamped or franked, addressed and placed in the post or in the case of personal delivery, was left at the correct address; and
- (b) in the case of a fax transmission, that fax was duly transmitted to the fax number, as appropriate, of the addressee referred to in clause 18.2.

19. ENTIRE AGREEMENT

19.1 This Agreement and any documents referred to in it or annexed to it constitute the whole and only agreement among the Parties or any of them relating to its subject matter and, for the avoidance of doubt, supersedes any other prior arrangement, understanding or agreement between the Parties or any of them relating to the subject matter of this Agreement.

19.2 Each Party acknowledges that in entering into this Agreement, it is not relying on any pre-contractual statement which is not set out in this Agreement.

19.3 Except in the case of fraud, no Party shall have any right of action against any other Party arising out of or in connection with any pre-contractual statement except to the extent that it is expressly provided for in this Agreement.

19.4 For the purposes of this clause 19, *pre-contractual statement* means any draft, agreement, undertaking, representation, warranty, promise, assurance, forecast, estimate or arrangement of any nature whatsoever, whether or not in writing, relating to the subject matter of this Agreement made or given by any person at any time prior to the date of this Agreement.

20. GENERAL

Secretary of State

20.1 Nothing in this Agreement fetters the powers conferred on the Secretary of State by the Act.

Costs

20.2 Save as expressly provided for elsewhere in this Agreement, each of the Parties shall at its own expense do all such things as shall be necessary to give full effect to the obligations imposed on it under this Agreement.

Third parties

20.3 For the purposes of the Contracts (Rights of Third Parties) Act 1999, no person other than a Party shall have any rights in respect of this Agreement.

Counterparts

20.4 This Agreement may be executed in any number of counterparts and by the Parties on separate counterparts, each of which when so executed and delivered shall be an original, but all the counterparts shall together constitute one and the same instrument.

Partial invalidity

20.5 If any term or provision in this Agreement is held to be illegal or unenforceable in whole or in part under any enactment or rule of law, such term or provision or part shall to that extent be deemed not to form part of this Agreement but the enforceability of the remainder of this Agreement shall not be affected.

Rights, variations and waivers

20.6 The rights and remedies of the Parties shall not be affected by any failure to exercise or delay in exercising any right or remedy or by the giving of any indulgence by any other Party or by anything whatsoever except a specific waiver or release in writing and any such waiver or release shall not prejudice or affect any other rights or remedies of the Parties. No single or partial exercise of any right or remedy prevents any further or other exercise thereof or the exercise of any other right or remedy.

20.7 No variation of this Agreement shall be of any effect unless it is agreed in writing by or on behalf of each Party.

20.8 Any waiver of any right, power or remedy under this Agreement must be in writing and may be given subject to any conditions thought fit by the grantor. The person seeking the waiver shall disclose to the grantor all material facts then in that person's knowledge relevant to the subject matter of the waiver. Unless otherwise expressly stated, any waiver shall be effective only in the instance and only for the purpose for which it is given.

Remedies

20.9 Without prejudice to any other rights or remedies that any Party may have, each Party acknowledges and agrees that damages alone would not be an adequate remedy for any breach by a Party of the provisions of this Agreement, and that the remedies of injunction and specific performance as well as any other equitable relief for any threatened or actual breach of the provisions of this Agreement by a Party may be more appropriate remedies and that no proof of special damages shall be necessary for the enforcement of this Agreement.

Governing law and jurisdiction

20.10 This Agreement and any non-contractual obligations arising out of or in relation to this Agreement shall be governed by and construed in accordance with English law.

20.11 Each Party hereby submits to the exclusive jurisdiction of the courts of England.

EXECUTED by the Parties on the date first written above.

Funding Agreement
EXECUTION VERSION

SIGNED by **OLIVER GRIFFITHS**
for and on behalf of
THE SECRETARY OF STATE FOR BUSINESS, INNOVATION & SKILLS

GRO

Signature:
Name: Oliver Griffiths
Title: Deputy Director, Shareholder Executive

SIGNED by
for and on behalf of
POST OFFICE LIMITED

GRO

Signature:
Name: S. Williams
Title: Co Sec

GRO

DAVID SMITH
CHIEF CUSTOMER OFFICER

SIGNED by
for and on behalf of
ROYAL MAIL HOLDINGS PLC

GRO

Signature:
Name: Jon Millard
Title: COMPANY SECRETARY

GRO

DAVID SMITH
CHIEF CUSTOMER OFFICER

SIGNED by
for and on behalf of
ROYAL MAIL GROUP LIMITED

GRO

Signature:
Name: Jon Millard
Title: Company Secretary

GRO

DAVID SMITH
CHIEF CUSTOMER OFFICER

SCHEDULE 1

DELIVERABLES

1. A certified copy of a resolution of the board of POL:
 - (a) approving the terms of, and the transactions contemplated by, this Agreement and resolving that it execute and perform this Agreement;
 - (b) authorising a specific person or persons to execute this Agreement on its behalf; and
 - (c) authorising a specified person or persons, on its behalf, to sign and/or dispatch all documents and notices to be signed and/or dispatched by it under or in connection with this Agreement.

2. Certified copies of resolutions of the boards of Mails and Holdings:
 - (a) approving the terms of, and the transactions contemplated by, this Agreement and resolving that it execute and perform this Agreement;
 - (b) authorising a specific person or persons to execute this Agreement on its behalf; and
 - (c) authorising a specified person or persons, on its behalf, to sign and/or dispatch all documents and notices to be signed and/or dispatched by it under or in connection with this Agreement.

SCHEDULE 2

Part A Fundamental Change

A Fundamental Change will have occurred if:

1. an order has been made or resolution has been passed for the winding-up of, or a provisional liquidator to be appointed in respect of, POL;
2. an administrator has been appointed in respect of POL;
3. a receiver (which expression shall include an administrative receiver) has been appointed in respect of POL;
4. POL has stopped paying its debts as they fall due;
5. a moratorium is declared in respect of the indebtedness of POL or POL enters into a moratorium or a composition, assignment or similar arrangement with its creditors generally;
6. a scheme of arrangement is approved, or proposed by POL, under Part 26 of the Companies Act 2006 with a view to rescheduling or restructuring POL's indebtedness;
7. a voluntary arrangement has been proposed by POL under section 1 of the Insolvency Act 1986 in respect of POL; or
8. an event analogous to the foregoing has occurred in relation to POL in any jurisdiction outside England.

Part B Potential Fundamental Change

A Potential Fundamental Change exists at any time if at that time a Fundamental Change shall not have occurred but:

1. a petition has been presented or a meeting has been convened for the purpose of winding-up POL or appointing a provisional liquidator in respect of POL and such petition has not been discharged or such meeting has not been held; or
2. POL is currently taking steps with a view to appointing an administrator or agreeing a moratorium, composition, assignment or similar arrangement with its creditors generally.

SCHEDULE 3

CALCULATION OF SGEI PAYMENT

The amount of the SGEI Payment shall (subject to clause 5.7 (*Government Funding for Services of General Economic Interest*)) be equal to all the direct and indirect costs associated with the provision by POL of services of general economic interest (*SGEI*) including:

1. all variable costs incurred in providing the SGEI; plus
2. all fixed costs incurred in providing the SGEI; plus
3. such proportion of fixed costs common to both the SGEI and other activities of POL as is appropriate to be allocated to the SGEI (based on generally accepted cost accounting principles); plus
4. a reasonable profit in providing the SGEI; less
5. the revenues received by POL from the SGEI.

For the purposes of paragraph 3 of this definition the fixed costs common to both the SGEI and other activities of POL shall include, without limitation, contributions to pension funds, interest costs, group central cost allocations, capital expenditure, contributions to the cost of any employee incentivisation arrangements and the costs of rationalising the network to maintain a network with optimal coverage for delivery of SGEI at minimum cost within the funding envelope, in each case whether such costs are recurring or exceptional.

APPENDIX A

POL ENTRUSTMENT LETTER

Post Office Limited
148 Old Street
London
EC1V 9HQ

For the attention of: Paula Vennells

[] October 2010

Dear Sirs,

ENTRUSTMENT OF POST OFFICE LIMITED WITH THE DELIVERY OF CERTAIN PUBLIC SERVICES

Commencement

This letter has effect from the later of: (i) the date on which the European Commission confirms that the schedule of services of general economic interest as set out in Annex A to this letter are compatible with the requirements on State aid of the Treaty on the functioning of the European Union; and (ii) 1 April 2012 (the "**Effective Date**").

Existing entrustment letter

Notwithstanding the signing of this letter, in respect of the period prior to the Effective Date, the provisions of the letter from the Secretary of State to Post Office Limited entitled "Entrustment of Post Office Limited with the delivery of certain public services" and dated 24 March 2010 (the "**Existing Entrustment Letter**") shall continue in full force and effect and the provisions of this letter shall be without prejudice to any rights, remedies, obligations or liabilities of any party accrued under the Existing Entrustment Letter.

The Existing Entrustment Letter shall be terminated on the Effective Date.

Entrustment

This letter contains an overarching ministerial instruction entrusting Post Office Limited with the provision and delivery of certain public services of general economic interest. This instruction is legally binding on Post Office Limited and Post Office Limited has signed this letter in agreement and acknowledgement of this.

Post Office Limited is required to provide a network of post office branches to make available the services of general economic interest detailed in Annex A ("**SGEI**"). Post Office Limited is entrusted with the delivery of these SGEI using its network in accordance with the contractual terms which apply to each service.

Specifically, the SGEI are provided under commercial contracts entered into by Post Office Limited and the Government department or body purchasing the service. In the case of universal postal services, the services made available at post office branches are ones which the universal service provider (Royal Mail Group Limited) is required to provide under the terms of its postal service licence.

The entrustment of the delivery of the SGEI set out in this letter to Post Office Limited does not replace or change in any way contracts and other agreements under which the terms of the provision of the individual SGEI are made. Post Office Limited is expected to use reasonable endeavours to enter into contracts with the Government department or body purchasing the service to provide the SGEI.

We confirm that Post Office Limited's public service obligation extends to maintaining a network of post offices beyond its optimum commercial size and providing services of general economic interest over that network from the start of its financial year on or around 1st April 2012 until its financial year ending on or around 31st March 2015. Additionally, as set out in the Post Office Limited Funding Agreement dated on or around the date of this letter (the "**2010 Funding Agreement**"), Post Office Limited will, as a minimum, be required to meet the following access requirements:

- Nationally, 99% of the UK population to be within 3 miles and 90% of the population to be within 1 mile of their nearest post office outlet.
- 99% of the total population in deprived urban areas across the UK to be within 1 mile of their nearest post office outlet.
- 95% of the total urban population across the UK to be within 1 mile of their nearest post office outlet.
- 95% of the total rural population across the UK to be within 3 miles of their nearest post outlet.

In addition the following criterion will apply at the level of each and every individual postcode district, establishing a minimum level of coverage at a very local level.

- 95% of the population of the postcode district to be within 6 miles of their nearest post office outlet.

Method of Calculating Compensation

As soon as reasonably practicable following publication of its audited accounts for the Financial Year 2014/15, Post Office Limited will be required to provide, in accordance with the 2010 Funding Agreement, a statement (the "**Cumulative SGEI Statement**"), accompanied by a supporting statement from an independent financial adviser, to confirm that the aggregate actual amount of the SGEI Payments made by the Government to Post Office Limited in respect of Financial Years 2012/13, 2013/14 and 2014/15 under the 2010 Funding Agreement did not exceed the direct and indirect costs incurred by Post Office Limited in connection with the provision of SGEI during those Financial Years, including::

1. all variable costs incurred in providing the SGEI; plus
2. all fixed costs incurred in providing the SGEI; plus
3. such proportion of fixed costs common to both the SGEI and other activities of POL as is appropriate to be allocated to the SGEI (based on generally accepted cost accounting principles); plus
4. a reasonable profit in providing the SGEI; less
5. the revenues received by POL from the SGEI.

in each case in respect of the relevant Financial Years.

For the purposes of paragraph 3 above, the fixed costs common to both the SGEI and other activities of Post Office Limited shall include, without limitation, contributions to pension funds, interest costs, group central cost allocations, capital expenditure, contributions to the cost of any employee incentivisation arrangements and the costs of rationalising the network to maintain a network with optimal coverage for delivery of SGEI at minimum cost within the funding envelope, in each case whether such costs are recurring or exceptional.

Recovery of Overpayment

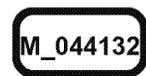
Notwithstanding clauses 5.2 of the 2010 Funding Agreement, in the event that the aggregate actual amount of the SGEI Payments made by the Government to Post Office Limited in respect of Financial Years 2012/13, 2013/14 and 2014/15 exceeds the costs incurred by Post Office Limited in providing the SGEI during those Financial Years, as calculated in accordance with the above formula, Post Office Limited will be required to repay to the Government, within 10 Business Days of the receipt by Government of the Cumulative SGEI Statement, an amount equal to such excess.

Edward Davey MP

Post Office Limited acknowledges that the instructions set out in this letter are legally binding.

Signed by _____)
for and on behalf of Post Office Limited)

Dated ___ October 2010



Annex A

**SCHEDULE OF SERVICES OF GENERAL ECONOMIC INTEREST
PROVIDED BY POST OFFICE LTD AT POST OFFICE BRANCHES**

	Category of service	Service provided	Service provided on behalf of
1.	Processing social benefit and tax credit payments to the public.	Cash payment of state benefits including state pension, child benefits and tax credits and encashment of benefit cheques. Cash payment of benefits and the issuing of vouchers to eligible asylum seekers. Cash payment of health benefits and the provision of form EHIC benefits	Department for Work and Pensions, Social Security Agency - Northern Ireland, Her Majesty's Revenue & Customs and financial institutions Home Office Department of Health.
2.	Processing of national identity and licensing scheme applications	Providing passport application forms for customers to complete and return to IPS Checking and authentication of passport applications and supporting documentation Providing vehicle licence application forms for customers to complete and return to DVLA, and budget cash savings schemes for licence fees. Receiving payment for vehicle licences and Photocard Licences, and checking Photocard application forms and supporting documentation.	The Identity and Passport Service ("IPS") IPS The Driver and Vehicle Licensing Agency ("DVLA") DVLA.
3.	Universal payment facilities for public utility services.	Provision of facilities for payment of electricity, gas, telecommunications and water bills. Payment options include pre-payment and other budgeting schemes (e.g. savings stamps).	Financial Institutions individual utility service providers, and billing service providers

	Category of service	Service provided	Service provided on behalf of
		Provision of facilities for payment of tax bills and social housing rents.	Her Majesty's Revenue and Customs, local authorities and housing associations.
4.	Universal postal service.	Provision of postal services which the universal service provider (Royal Mail Group Limited) is required to provide under its postal services licence	Royal Mail Group Limited.
5.	Universal access to basic cash and banking facilities and Government savings instruments, especially for rural customers and those on social benefits.	Provision of basic community banking facilities (cashing of cheques, cash deposit, Post Office card account and automated cash withdrawals and deposits) and cash transmission facilities (postal orders), in particular to socially excluded customers. This includes deposits and withdrawals of cash by businesses local to Post Office branches. Access to Saving Gateway accounts and Government savings instruments including Premium Bonds, Investment Accounts, Children's Bonds and National Savings certificates.	Financial Institutions including Her Majesty's Treasury, the Government-owned National Savings & Investments, the Department for Work and Pensions, the Social Security Agency - Northern Ireland, and Her Majesty's Revenue & Customs.

Funding Agreement
EXECUTION VERSION

APPENDIX B
STRATEGIC PLAN

Delivering a sustainable and relevant Post Office

Government Funding and Strategic Plan (2012/13 to 2014/15)



Commercial in confidence
25th October 2010

Government Funding and Strategic Plan - Executive Summary

GOVERNMENT FUNDING

HM Government has entrusted Post Office Ltd to maintain a network of at least 11,500 Post Offices meeting certain access criteria and through that to provide certain SGEI services. This places a material financial obligation on Post Office Ltd so, in order for these obligations to be met, Post Office Ltd requires on-going Government funding. To further minimise the funding required Post Office Ltd also provides some non-SGEI services the revenues from which contribute to the SGEI funding.

STRATEGIC PLAN

Post Office Ltd has created a strategic plan which addresses the challenges the business faces, and puts the Post Office network and the ongoing provision of SGEI services on a more sustainable footing. This document outlines that plan.

The Post Office network is a valuable national asset which positively contributes to communities the length and breadth of the United Kingdom. A report for Postcomm on the social value of the Post Office network found that its annual social value is upwards of £2.3B¹. However the network as currently constituted requires ongoing reform if the delivery of the SGEI services and the social value is not to be at risk over time. In particular Post Office Ltd needs to address the uneconomic legacy network operating models – and specifically the Subpostoffice model. Not only are the legacy operating models uneconomic for Post Office Ltd, but also for many agents (due to staffing costs and the lost opportunity cost of retail space foregone), and most importantly they do not meet the needs of customers in the 21st century. Post Office Ltd's strategic plan aims to modernise the models to the benefit of Post Office Ltd, its shareholder, Post Office agents, customers and UK communities.

CHALLENGES

- Customer relevance challenge: the Post Office continues to see accelerating decline in traditional revenues, intensifying competition and substitution across all our markets. This is leading to a diminishing sense of relevance among many of our customers for the Post Office brand, which is further driven by the Post Office falling behind customers' channel experience expectations.
- Operating model challenge: the customer challenge is in part driven by our network operating models which are inflexible, expensive, high in fixed cost for Post Office Ltd and also low-yield, high cost for Post Office Ltd's agents.
- Financial challenge: While Post Office Ltd has returned to an operating profit level in recent years (inclusive of Government SGEI compensation), the business has not begun to generate cash and the outlook is one of decline and ever increasing subsidy unless the business is able to solve the customer relevance and operating model challenges it faces and also to innovate in growing new revenue streams.
- Shareholder challenge: Government requires Post Office Ltd to retain its current network size, reduce its reliance on subsidy, grow revenues and ensure alignment of interest with agents.

THE PLAN

Post Office has put together a holistic plan which addresses the challenges the business faces:

- Defend Traditional Income: by improving customer experience across all channels, by offering tailored mails services for SMEs and by extending network coverage for relevant services
- Innovate and grow new income streams: particularly from making the interface between Government and citizens more efficient via identity verification and application management services.
- Modernise channels: by extending opening hours, improving the in-store environment and reducing queues in the network and through extending and improving the online offering. In the network Post Office Ltd will introduce new, more flexible, operating models which better integrate the Post Office

¹ [HTTP://www.nera.com/extImage/PUB_Postcomm_Aug2009.pdf](http://www.nera.com/extImage/PUB_Postcomm_Aug2009.pdf)

with the host retail business and remove entitlements to fixed pay and compensation from agents' contracts.

- Address cost base competitiveness: by buying down pay and reviewing the number of Crown Offices, by driving efficiencies in our support operations and by removing fixed pay in the agency network.
- Engage our people: Post Office will engage its people and agents by ensuring that focus on customers is at the heart of the business and via reward structures that ensure alignment of interests.

OUTCOMES

- Post Office Ltd will maintain the network of ~11,500 Post Office branches, the majority of which will offer extended opening hours and significantly improved customer experience. Post Office Ltd will also investigate extending its bill payment network significantly through partnerships. In particular this modernised network will better meet the future needs of Royal Mail and their customers, and in doing so make Post Office Ltd the mails channel of choice for small businesses and consumers.
- Post Office Ltd will eradicate the loss generated in the Crown Office network through pay rebalancing and by reviewing the number of directly managed branches.
- Post Office Ltd will transform the franchise proposition for its agents, reducing their cost base, simplifying their operations, driving new revenue streams and investigating the introduction of mechanisms for agents to share in the success of a transformed business.
- Post Office Ltd will offer direct channels that account for a material proportion of revenues and enable a multi-channel experience alongside the network channels providing customers with real channel choice.
- Income will grow by ~£60m during the Spending Review Period to 2014/15 (compared to 2010/11 forecasts) despite some declines in traditional markets and if Post Office Ltd were able to complete the remainder of its plan in 2015/16 and 2016/17, it would achieve a steady state growth of around £200m.
- Costs will absorb inflation and the introduction of additional functionality (e.g. CRM and ID Services), and will become further variabilised.
- Post Office Ltd will deliver a marginally positive annual cash flow exit rate at the end of 2014/15 with an NSP payment that is in decline (£160m in 2014/15), and if Post Office Ltd were able to complete the remainder of its plan in 2015/16 and 2016/17, then at maturity NSP would be ~£50m p.a. and annual cash flow would be positive by ~£25m.

RISKS TO THE PLAN

There are a number of risks to the plan which are covered in section 6 of this document; the five most critical risks are:

- Pensions settlement not being implemented,
- Failure to obtain State Aid approval,
- Slower growth in New Government Services income,
- Retail mails revenues lower than forecast, and
- Network programme not being deliverable.

UPSIDES TO THE PLAN

There are also a number of potential upsides to the plan which are covered in section 7 of this document:

- More new Government Services income coming through,
- Innovation proposition revenues higher than forecast over the plan period,
- A greater than assumed contribution from Personal Financial Services, and
- The network programme being delivered under budget.

Post Office Strategy - Part 1, Government Funding

The UK post office network remains at the heart of communities nationwide with ~11,500 branches (including 500 Outreach services) serving around 20 million customers each week.

The Government is clear that there is a continuing social need for a network of Post Offices, providing SGEIs throughout the country, which cannot be provided by networks other than the Post Office network, or through internet or telephone-based access. In particular, the dispersed nature of the UK population means that a commercially optimal network, which would very largely be located in densely populated urban areas, would be insufficient to meet the needs of many communities.

In recognition of this, the Government funds Post Office Ltd to enable the continued provision of SGEIs across a network which is larger than the optimum commercial size. In return Post Office Ltd provides a network of 11,500 Post Offices and adheres to the access criteria. The expansion of the network through the introduction of the Basics model will not increase the network SGEI costs incurred as Basics will only operate in locations where it is commercially viable in absence of subsidy.

In addition to the network requirements described above, Post Office Ltd has been entrusted by Government to provide the following SGEI services (these are set out in the Entrustment Letter and summarised below):

1. Processing social benefit and tax credit payments to the public;
2. Processing of national identity and licensing scheme applications;
3. Universal payment facilities for public utility services;
4. Universal postal service; and
5. Universal access to basic cash and banking facilities and Government savings instruments, especially for rural customers and those on social benefits.

These services are entrusted to Post Office Ltd by way of a letter authorised by Edward Davey MP signed on 25th October 2010 and covers the funding period 12/13 to 14/15 (the "Entrustment Letter"). A similar letter from Pat McFadden to Mike Moores dated 24 March 2010 entrusts Post Office Ltd to provide these services in 2011/12.

Government does not compensate Post Office Ltd for the full cost of its SGEI provision and does not compensate Post Office Ltd for non-SGEI in any way. Post Office Ltd provides non-SGEI products with the sole purpose of reducing the funding requirement generated by the provision of the SGEI requirements. These products include Telephony, Personal Financial Services and Travel. In addition these non-SGEI products generate agents pay which would probably have to be paid in order to make the agents economically viable -- this benefit however is not taken into account within POL's accounts.

Government envisages that it is likely it will continue to require Post Office Ltd to maintain the network and provide the SGEI services through that network beyond the current funding period and accordingly also require Post Office Ltd to take reasonable actions to reduce the longer term costs of the SGEIs and the network and to increase the amount of contribution generated from non-SGEI services. It should be noted that the actions Post Office Ltd plans to take to reduce the longer term cost of the SGEIs and the network through which the SGEIs are provided are counted as SGEI cost within the funding period.

POL's accounts are split into SGEI and non-SGEI with direct income and costs attributed to the respective parts of the business. Fixed costs are allocated to both parts of the business.

The amount of funding provided by Government is restricted to the costs of SGEI over this period by EU State Aid rules. The total amount of funding Government will provide to Post Office Ltd over the period 12/13 to 14/15 is less than the SGEI costs for the same period and - along with an indicative forecast of the quantum of the SGEI costs - is set out in the following table:

	(£m)	2012/13	2013/14	2014/15	Total
1	SGEI Cost (broken down at Annex 1)	(497)	(468)	(410)	(1,375)
2	NSP	210	200	160	570
3	Other Government Funding	200	215	170	585
4	Total SGEI Funding (sum of lines 2 and 3)	410	415	330	1,155*
5	POL contribution to SGEI costs (the negative of the sum of lines 4 and 5 equal line 1)	87	53	80	220

* 2011/12 NSP is not new funding and is covered in the 2011/12 Funding Agreement. The total with that funding would be £1,335m

Within the funding period Post Office Ltd will deliver the strategic plan as set out in Section 2 of this document.

Post Office Strategy - Part 2, Strategic Plan

1. The case for change

- There are a number of factors that combine to create real pressures on the Post Office business model and the company's ability to meet Government objectives around maintaining the network and delivering SGEIs:

External Environment	Operating Constraints
<ul style="list-style-type: none"> Customer demands are fast shifting due to technology, lifestyle and widened choices for fulfilling needs; they want enhanced convenience, better opening hours, high retail standards and quick tailored service in obtaining the services they demand from Post Offices Markets and competition are evolving much faster, becoming sharper and widening into the key mails pillar, through a mixture of electronic substitution and competitors diversifying their offerings into adjacent market places, or small retailers seeking to replicate Post Office service provision Agents face escalating costs, Post Office pay reduction and loss of footfall which coupled with the recessionary impacts in their retail businesses are leading to more of them becoming economically unsustainable. This is now becoming acute for larger branches and multiple partners as well Public opinion does not want to see further closures and wants 'social value' maintained. The national role and social cohesion of the Post Office network remains treasured. 	<ul style="list-style-type: none"> The Government as Shareholder has a number of policy objectives with regards to the Post Office including: maintaining the network at ~11,500, avoiding any closure programme, meeting the access criteria and delivering the Services of General Economic Interest Stakeholders (special interest groups and MPs) want a reliable network as part of a national infrastructure, providing key services and delivering significant 'social value' for the UK and vulnerable customer groups Post Office Ltd has a legacy of inflexible and expensive operating models in the network (which work for neither Post Office Ltd nor agents) which are enshrined in practice and in contract Clients (including Government Departments) need to be able to access 'fast, transaction services' (requiring high levels of network coverage, convenient locations and opening hours) and / or 'secure, complex services' (requiring efficient mass distribution channels for face to face services with highly skilled, trusted customer facing people).

- Overall these drivers combine to create a position where the business has to spend increasing levels of cash to sustain the network. Even additional cash payments by way of fixed agents pay will ultimately fail as declining footfall undermines the business models of the agents themselves.
- The challenge to the Mails market is particularly acute. This market accounts for 38% of Post Office Ltd's income, 46% of agents' variable pay and 35 to 40% of footfall. Post Office's market share is at risk from a number of areas:
 - Failure to meet customer and client expectations – customer loyalty is declining largely due to queuing and to uncompetitive opening hours. This in turn potentially undermines Royal Mail's commitment to Post Office Ltd as a channel in the medium term,
 - Continued electronic substitution across the mails market – Post Office Ltd is the only Royal Mail Group retail channel in decline currently (compared to direct channels such as On Line Postage),
 - New competition – this risk has increased notably with the establishment of competitor networks and a growing risk of operators consolidating customer mail and entering the Royal Mail pipeline through account based products.
- The market for personal financial services is also in flux due to the banking crisis and the recession. While an opportunity exists for Post Office Ltd to extend its personal financial services business - building on its trust, reach and the foundations of Forward:five2eleven - other entrants such as Tesco and Virgin are also looking to expand their role and operate in the same trusted space that the Post Office brand could exploit. It is critical that Post Office Ltd is able to progress its proposition consistent with market evolution.
- There is also a real opportunity for Post Office Ltd to develop new Government Services which focus on two key public requirements: firstly, allowing Government Departments and Agencies to reduce their costs and secondly, providing a physical access channel to direct services for digitally excluded customers.
- A failure by Post Office Ltd to react now to the challenges and opportunities it faces will lead to an irrecoverable position where the network starts to contract due to uncontrolled closures and where

the business has lost many of its customers. In this scenario there is unlikely to be any further opportunity to subsequently arrest the decline of the network.

2. Commercial Strategy

CUSTOMER FOCUS

- The most fundamental issue Post Office Ltd faces is one of customer relevance and accordingly the strategy has at its heart a relentless focus on understanding and meeting developing customer needs.
- Post Office Ltd has developed an aspirational vision to become “The People's Post Office, always socially and commercially relevant by providing essential services for a fair return”. This vision has in turn led to three Customer Change principles which underpin all elements of the strategic plan:
 - Increase Accessibility: Post Office Ltd will aim to offer customers a wider choice of channels, to make more products and service available online and on a multi-channel basis, to maintain the network at 11,500 Post Office branches, to provide more convenient locations with longer opening hours, and to tell customers about these developments.
 - Improve Branch Experience: Post Office Ltd will aim to reduce queues, to provide rapid, convenient access, to offer the choice of automation suited to customer needs, to maintain clean branches with high retail standards, to deliver trusted, helpful and informed customer service, and to provide closer integration with the existing retail offering.
 - Enhance products: Post Office Ltd will aim to provide simpler, more customer-friendly and more easily accessible products, to offer customers the right range of products to meet their needs, and to ensure products offer good value for money.

MAILS STRATEGY

- The main focus of the mails strategy is to address the issues Post Office Ltd currently has with the customer experience issues. Much of this improvement will be delivered by the channel strategy, and the three strategically vital areas for improvement remain:
 - Reducing queue times in the Premier and Main Post Offices delivering Mails capacity,
 - Extending opening hours to meet the needs of our customers, and
 - Improving the in-branch experience of customers, in particular small businesses
- In addition to the medium term improvements delivered by the network strategy Post Office Ltd will also focus on:
 - Queue busting solutions for Premier and Main Post Offices,
 - Extending functionality and deployment our of Post & Go self service kiosks,
 - Creating a compelling pre-paid mails range,
 - Improving collection services,
 - Developing the mails specialist role,
 - Developing targeted small business propositions and account management solutions,
 - Developing and supporting online mails services,
 - Investigating opportunities as a mails aggregator

GOVERNMENT SERVICES STRATEGY

- Post Office Ltd plans to become the physical channel alternative to Government's own direct channels for those customers who cannot interact online and for those services that require a physical touch point.
- This aspiration will support Government objectives around universal access to services, removing paper and complexity and enabling digitisation of administration, as well as providing material savings opportunities.
- Post Office Ltd plans to develop and offer three main propositions to Government departments and agencies:
 - Identity and verification: to become Government's consolidated channel for authenticating and verifying customer identity and credentials,
 - Assisted digital applications: become Government's physical exception channel for the digitally excluded, and
 - Data re-use: over time, make customers' lives easier - and enabling Government's 'Tell Us Once' aspirations - by storing and re-using customer consented data.

FINANCIAL SERVICES STRATEGY

- Post Office Ltd's financial services portfolio remains broad and its strategy contains a variety of differing aspirations in the various sub-markets:

- Personal Financial Services: Post Office Ltd plans to re-focus business around savings and mortgage products while limiting exposure on insurance, to improve the online offer significantly, to review the branch capacity and focus, and to renegotiate the relationship with the Bank of Ireland to deliver a proposition which reflects customer needs and preferred channel choices,
- Bill Payments: Post Office Ltd plans to partner with one or more suitable network terminal operators or point of sale providers to dramatically increase the number of locations where Post Office bill payment is offered,
- Personal Banking: Post Office Ltd plans to increase the number of partner banks who allow their customers to undertake cash withdrawals and deposits in Post Office branches, with an aspiration to have all major high street banks signed up,
- Travel Services: Post Office Ltd plans to maintain their position in the market,
- Financial Inclusion: Post Office Ltd plans to develop its relationship with ABCUL and individual credit unions with a view to helping them make their service more accessible.

TELEPHONY & INNOVATION STRATEGY

- Post Office Ltd's Telephony strategy is to continue to provide fixed line and broadband propositions that meet the need of the business' core customers, presenting the proposition as a simple and competitive alternative to BT and focusing sales activity more on direct channels.
- At the same time Post Office Ltd will:
 - Look to improve the customer proposition to keep pace with the market,
 - Assess the opportunity for launching a simple mobile offer, and
 - Investigate the value of installing '4G' repeaters across the branch network.
- Post Office Ltd will also develop a much greater focus on innovation, setting aside funds to develop new propositions. In addition to the '4G' and mobile concepts in Telephony and the new Government Services detailed above, Post Office Ltd will also investigate:
 - Online mails services aimed at supporting growth in mails fulfilment,
 - Payments solutions which will support the phasing out of cheques, and
 - Further self-service solutions.

3. Channel Strategy

OVERALL NETWORK STRATEGY

- The network strategy aims to:
 - Maintain geographic accessibility, network capabilities and social value for the benefit of customers,
 - Undertake a network modernisation programme to ensure customers can access services through channels that meet their needs and expectations,
 - Offer a ~40% increase in opening hours giving greater convenience ,
 - Ensure queues are reduced so that 90% of customers are served within 5 minutes,
 - Bring the Crown Office network to break even through pay rebalancing and a review of the number of Crown Offices (within the bounds of contractual obligations),
 - Create branch models that are profitable for Post Office Ltd and for Agents,
 - Change all agency contracts within the scope of the network programme set out within this strategic plan to fully variabilised pay and remove the right to compensation on termination other than for breach of contract by Post Office Ltd, and
 - Manage the transition from the current network structure to one that is more fit for purpose and cost effective in a smooth, customer oriented way which compensates agents appropriately, minimises adverse public opinion and which takes account of local community views. As part of this transition, Post Office Ltd will not remove any provision from a community where a service currently exists other than for reasons beyond Post Office Ltd's control.

The network will be modernised along the operating model lines set out below in this section. Details of the purpose, role and product set for each operating model is included at Annex 2.

CROWN OFFICES AND PREMIER BRANCHES

- Post Office Ltd plans to buy down Crown Office pay and to review the number of Crown Offices retained. Current plans envisage around 140 directly managed branches being retained (subject to amending certain existing contracts) which would become Premier branches focusing on sales of personal financial services along with a further 60 agency run premier branches. Post Office Ltd is committed to moving the remaining Crown Office network to break even position within the funding period, eliminating an annual cash loss of ~£50m.

MAIN POST OFFICES

- Post Office Ltd plans to modernise 4,000 larger branches, and to relocate 1,000 of these to new partners better able to meet customer needs.
- Main Post Offices will be better integrated with the host retailers business allowing for extended opening hours, have excellent retail standards (delivered through refurbishments and through new partner investments), and will deliver capacity for retail mails and new Government services as well as continuing to generate personal financial services and telephony leads for direct channels.
- New agents taking on Main Post Offices (including Premier branches) as part of this programme will be expected to make a material investment in setting up their branches, matching the investment being made by Post Office Ltd.

POST OFFICE ESSENTIALS, OUTREACH AND BASICS+

- Post Office plans to introduce the Post Office Essentials model across the majority of the remaining agency network, however within the plan period up to 2014/15 it will only create 2,000 of the planned 6,000 Essentials branches that are planned to be introduced by 2016/17. Around half of the new Essentials branches will be operated by new agents in new premises.
- Post Office Essentials branches will be fully integrated with the host retail business, freeing up retail space and allowing for staff efficiencies as well as increased opening hours. This means that Post Office Ltd will be able to pay Essentials agents on a variable basis only, removing fixed pay from the network.
- In addition the product range in an Essentials branch will be simplified to remove those manual products that make up a small minority of the customer demand but disproportionately increase the cost and complexity of the branch model.
- Post Office Ltd also plans to increase the number of Outreach by around 200 locations and to introduce a Basics+ model in around 750 locations (which offers simple mails, bill payment and POCA cash

withdrawals only) to ensure that all communities with an existing Post Office service continue to receive the provision they need but on a more economic basis.

BASICS MODELS

- Post Office Ltd plans to extend its network by adding around 3,000 brand new Basics models. These will be light touch models providing simple mails and automated bill payment services at point of sale in locations where demand allows. These will mostly be in urban and suburban locations and will be critical for Post Office Ltd in targeting mails and bill payment convenience transactors.
- In addition to the Basics model, and as described above, Post Office Ltd will also investigate partnering with one or more parties to extend its bill payment provision. Potential partners could include the operators of point of sale terminal networks. Up to 20,000 additional bill payment locations could be added through this approach.

COMPENSATION POLICY

- Post Office Ltd plan to compensate existing agents for the introduction of these changes along the following lines:
 - Compensation will only be paid to agents leaving the business or to agents who remain on acceptance of the revised contract terms,
 - New contract terms will be introduced on 1st April 2012 for all changing agents. These contracts will embrace a number of changes including: a move to fully variable pay, the removal of any right to future compensation and clearly defined customer experience service levels (including opening hours and queuing performance),
 - Existing Agents – i.e. those currently holding a contract for services - will be required accept the new contract terms at the latest by December 2016 (at which point Post Office Ltd will serve notice on any who have failed to do so),
 - Compensation will only be paid to existing agents when the new contracts are signed.
 - Compensation will be paid against a base factor of 18 months pay, with those agents leaving the business receiving 18 months of full pay and those remaining receiving 18 months of fixed pay plus 18 months of variable pay for those products that are being withdrawn (in the case of Essentials),
 - 18 Months has been chosen as the base factor because it closely equates to the re-sale value of a Subpostoffice on the open market currently and this has been discussed with the NFSP executive.
 - The exception to the 18 month base factor rule is that those agents who remain and who operate Main Post Offices will receive a smaller amount of compensation, referred to as a transition payment, which is intended to bridge the gap between fixed pay being removed and a material amount of new Government Services income being delivered. In addition to these transition payments, these agents will also receive a significant contribution towards the refurbishment which becoming a Main Post Office requires.

NETWORK IMPLEMENTATION

- The network strategy will be implemented on a semi-voluntary basis using a programmatic approach, taking best practice from previous network programmes. The detailed plan for the programme will be built up over time and will take account of the views of the NFSP, local authorities and communities.
- Underpinning this programme of network modernisation are two core principles; firstly, that there will be no planned closures instigated by Post Office Ltd and secondly; that the Government's stated requirements for access will continue to be met. This does not mean that branches will not be moved to new locations in circumstances where doing so strengthens the sustainability of the branch and/or enhances the service offer to customers, but it does mean that communities who have a Post Office service at the commencement of the plan will continue to do so. In cases where Post Office closes for reasons outside Post Office Ltd's control the company ("**Unplanned Closures**") will, as now, take all reasonable steps to replace that service so that community access to services is not lost.
- Where the Code of Practice requires Post Office Ltd to consult on a change then Post Office Ltd will do so in accordance with the Code of Practice that is current at that time for the purpose of delivering this modernisation plan. For the purposes of this plan Post Office Ltd has assumed the following obligations:
 - Where an existing Post Office converts on site to either a Main Post Office or an Essentials branch Post Office Ltd will advise customers of the change 4 weeks in advance, through communications displayed in branch, and
 - Where a new Post Office branch (Main Post Office, Essentials or Outreach) is to be established in a community - but in a new location that is likely to materially affect the accessibility of that branch for a significant proportion of customers - then Post Office Ltd will consult on relevant issues for a period of up to 6 weeks;

The above arrangements do not cover changes to the network that are outside the strategic plan and / or Post Office Ltd's control, namely Unplanned Closures.

- The programme will be "semi-voluntary" in nature, meaning that those agents who have a valid contract in place on 1st April 2012 will have some choice as to when they adopt the new models into their businesses, but that this period will have an end date upon which contract and operating model changes become mandatory.

- The full network programme will take five years to complete (from 2012/13 to 2016/17), and the current funding period does not cover the full programme. The table below sets out the broad shape of the programme as currently envisaged (but prior to detailed planning) for the funding period to 2014/15.

Current Network (~11,388)	The Network Transformation Plan				New State	Network at the end of 14/15
	Year 1 2012/13	Year 2 2013/14	Year 3 2014/15	Total		
CROWNS (373)	10	25	15	50	90 Premier (directly managed On-site) Premier (directly managed, hosted)	PREMIER (200) LARGE (1,500)
	50	90	93	233	Large (Agent operated)	
FRANCHISE (424)	10	25	25	60	Premier Branch	MEDIUM (1,300) SMALL (1,200)
	70	130	130	330	Large Branch	
AGENCY BRANCHES (10,261)	5	15	15	34	Medium Branch	LEGACY MODELS (3,850) PO ESSENTIALS (2,000) OUTREACH (1,000)
	200	320	370	890	Large Branch	
	325	470	470	1,265	Medium Branch	
	350	450	450	1,250	Small Branch	
	3,000	2,000	2,000	7,000	POE (3,950 in 2015-17)	
	40	50	80	170	Outreach	
POE (49)				49	Remain POE	BASICS + (750)
OUTREACH (781)		3,000		3,000	Remain Outreach New Basics	
						BASICS (3,000)

DIRECT CHANNELS

- Post Office Ltd plan to improve its direct channels further, plans include:
 - Introducing CRM, data management and improved web functionality,
 - Growing personal financial services and telephony sales,
 - Extending the range of service offered including introducing direct only offers,
 - Giving customers more choice around how they interact with postoffice.co.uk,
 - Providing greater alignment and consistency of voice across Post Office's contact centre channels

4. Delivery Strategy

TECHNOLOGY

- Post Office Ltd has developed a technology strategy that supports the overall strategy, reduces the cost of operation and satisfies the demands of the business for new products, services and operating models. The technology strategy will be delivered through the provision of industry standard solutions and Post Office Ltd will adopt “off the shelf components” where possible and maximise reuse and value for money.
- The main elements of the technology road map will be:
 - Need To Do items including: pin-pad replacement, branch counter hardware refresh and Paystation renewal,
 - Cost Reducing items including: core Horizon system development (including preparation for replacement), introduction of unified branch engineering and rationalisation of branch telecoms,
 - Strategic Development items: development of a service orientated architecture service layer, improvements to management information and business intelligence capabilities, consolidation of desktop, engineering and hardware contracts,
 - Channel strategy supporting: development of point of sale and other systems to support the new branch operating models, development of functionality to support the direct channel strategy, enhancements to Post & Go and roll out of more units, development of queue measurement and management solutions,
 - Commercial strategy supporting: introduction of a Customer Relationship Management system, development of data management solutions to enable Post Office Ltd to strengthen and leverage our customer, product and transaction information, and the development of functionality and hardware to deliver the new Government Services propositions.

PEOPLE AND ENGAGEMENT STRATEGY

- Post Office Ltd will deploy a People Engagement plan aiming at ensuring the whole organisation including agents is aligned behind the strategic plan. This will feature:
 - A clear focus on the customer centricity of the plan,
 - The deployment of a clear set of leadership standards and behaviours,
 - A reward structure focused on delivering objectives, and
 - The development of any gain share mechanism or mutualisation structure required by Government.

COST REDUCTION

- Post Office Ltd will also reduce its cost base in delivering the strategic plan. The total operating cost of the business will stay materially the same but will absorb inflation and add new channel and technology functionality within that cost envelope. Key cost reduction drivers include:
 - Delivering the changes to Crown Offices will reduce staff costs by ~£60m p.a.,
 - Reducing the cost of central and supporting staff through ongoing organisational development & management and through the introduction of more Single Person Vehicles in supply chain will reduce staff costs by ~£20m.
 - Delivering the new agents contracts will remove fixed pay by ~£110m (while agents retain much of their income as variable pay, critically, it is then dependent on revenue levels).

4A. *Milestones and Milestone Test Dates*

Milestone	Milestone Test Date	Requirements
1	31 March 2012	<p>Network size and scope:</p> <ul style="list-style-type: none"> • As demonstrated by the then most recent report submitted to the House of Commons library (subject to any updates notified by POL), POL's network continues to number at least 11,500 Branches in accordance with clause 12(1)(a) of the Funding Agreement. • POL's network continues to meet the access criteria set out in clause 12.1(b) of the Funding Agreement. <p>Any shortfall caused by Unplanned Closures, which POL can demonstrate it is taking steps to remedy, will be deemed not to be a failure to meet this milestone.</p> <p>Network contract:</p> <ul style="list-style-type: none"> • POL has developed replacement sub-postmaster contracts to ensure that under the new contract no sub-postmaster has any right to receive: (i) fixed pay; or (ii) any compensation payment for termination of that contract (other than for breach by POL of the contract or under applicable law). <p>Annual plan:</p> <ul style="list-style-type: none"> • POL has presented a plan for the Financial Year 2012/13 setting out the steps it will take in respect of the Strategic Plan (or any variation to it, agreed by the Parties where material) during that Financial Year (an "Implementation Plan"). This Implementation Plan will include: <ul style="list-style-type: none"> - POL's annual budget; and - POL's network strategy, including details of the commercial rationale for the same. <p>SGEI Statements:</p> <ul style="list-style-type: none"> • POL has presented the NSP Statement and the Supporting Statement for the Financial Year 2010/11.
2	31 March 2013	<p>Network size and scope:</p> <ul style="list-style-type: none"> • As demonstrated by the then most recent report submitted to the House of Commons library (subject to any updates notified by POL), POL's network continues to number at least 11,500 Branches in accordance with clause 12(1)(a) of the Funding Agreement. • POL's network continues to meet the access criteria set out in clause 12.1(b) of the Funding Agreement. <p>Any shortfall caused by Unplanned Closures, which POL can demonstrate it is taking steps to remedy,</p>

		<p>will be deemed not to be a failure to meet this milestone.</p> <p>Annual plan:</p> <ul style="list-style-type: none"> ◦ POL has presented an Implementation Plan for the Financial Year 2013/14 setting out the steps it will take to deliver the Strategic Plan (or any variation to it, agreed by the Parties where material) during that Financial Year. This Implementation Plan will include: <ul style="list-style-type: none"> - POL's annual budget; - POL's network strategy, including details of the commercial rationale for the same; and - A reconciliation of the steps it took under its Financial Year 2012/13 Implementation Plan back to the Strategic Plan, including a breakdown of changes to the network. <p>SGEI statements:</p> <ul style="list-style-type: none"> ◦ POL has presented the NSP Statement and the Supporting Statement for the Financial Year 2011/12.
3	31 March 2014	<p>Network size and scope:</p> <ul style="list-style-type: none"> ◦ As demonstrated by the then most recent report submitted to the House of Commons library (subject to any updates notified by POL), POL's network continues to number at least 11,500 Branches in accordance with clause 12(1)(a) of the Funding Agreement. ◦ POL's network continues to meet the access criteria set out in clause 12.1(b) of the Funding Agreement. <p>Any shortfall caused by Unplanned Closures, which POL can demonstrate it is taking steps to remedy, will be deemed not to be a failure to meet this milestone.</p> <p>Annual plan:</p> <ul style="list-style-type: none"> ◦ POL has presented an Implementation Plan for the Financial Year 2014/15 setting out the steps it will take to deliver the Strategic Plan (or any variation to it, agreed by the Parties where material) during that Financial Year. This Implementation Plan will include: <ul style="list-style-type: none"> - POL's annual budget; - POL's network strategy, including details of the commercial rationale for the same; and - A reconciliation of the steps it took under its Financial Year 2013/14 Implementation Plan back to the Strategic Plan, including a breakdown of changes to the network. <p>SGEI statements:</p> <ul style="list-style-type: none"> ◦ POL has presented the SGEI Statement and the SGEI Supporting Statement for the Financial

		Year 2012/13.
--	--	---------------

5. Financial position

MAJOR AREAS OF SPEND

- In delivering this strategic plan Post Office Ltd forecasts it will incur the following:

£m	2012/13	2013/14	2014/15	Total
Agents compensation – this is the total amount to be paid to agents in respect of buy-out (for those exiting), buy-down (for those converting on-site other than Main Post Offices) and transition payments (for on-site Main Post Office conversions)	90	90	90	270
Project costs – this is the amount required to deliver the network programme and includes staff costs, travel & subsistence, agents training, consultation & communications costs and legal fees	30	25	25	80
Network Development costs – this is the amount to be spent on the infrastructure of branches as part of the network programme and includes refurbishment costs for Main Post Offices and point of sale positions and materials for Essentials and Basics models	65	70	35	170
Channel supporting strategy – this is the amount to be spent on Post & Co development and deployment and queue management & measurement systems	15	15	0	30
Direct – this is the amount Post Office will contribute to the development of its Direct channels and includes the development of a Customer Relationship Management tool	15	15	0	30
Crown Offices – this is the amount to be spent to buy-down pay, cover property exits and to fund compromise agreements for those staff working in branches which convert to agency models	40	30	30	100
Support Restructuring – this is the amount to be spent on severance for support staff and Supply Chain staff	20	20	0	40
Need to Do Technology – this is the amount to be spent on unavoidable Technology developments and include the replacement of PIN pads and the refresh of counter hardware (PCs, screens and peripherals)	27	27	26	80
Total Post Office spend	302	292	206	800

Post Office Ltd will seek external investment from new and existing partners in order to deliver some commercial elements of the plan.

STRATEGIC PLAN FORECAST FINANCIAL STATEMENTS

- Post Office Ltd forecasts the following business profit and cashflow when the strategic plan is delivered (the key assumptions which underpin this forecast are included at Annex 3):

Profit & Loss (£m)	2010/11	2011/12	2012/13	2013/14	2014/15	2016/16	2016/17
Income	907	872	899	923	966	1,025	1,084
• Mails	339	331	337	336	338	340	346
• Financial Services	322	305	303	301	292	294	290
– Personal Financial Services	32	36	36	38	37	42	41
– Other FS	290	269	267	262	254	252	249
• Government & ID Services	144	139	143	157	197	240	284
– POCA	71	69	67	62	58	52	48
– Other existing services	74	68	51	45	41	37	36
– New services	0	0	25	50	100	150	200
• Other (inc innovation)	102	99	117	128	139	151	164
Total Costs	(1,026)	(1,022)	(1,026)	(1,020)	(1,027)	(1,025)	(1,027)
• Agents Pay	(478)	(479)	(493)	(525)	(560)	(564)	(577)
• Staff Costs	(252)	(252)	(224)	(194)	(169)	(161)	(154)
• Central & supporting	(286)	(291)	(303)	(289)	(276)	(267)	(254)
• Other Costs of new income	0	0	(6)	(12)	(22)	(32)	(42)
Outcomes							
• NSP	150	180	210	200	160	130	80
• Operating Profit	31	30	84	102	99	130	137

Cashflow (£m)	2010/11	2011/12	2012/13	2013/14	2014/15	2015/16	2016/17
Operating profit	31	30	84	102	99	130	137
Working capital	28	(12)	(107)	54	13	4	10
Capital Expenditure (Tangible & Intangible)	(35)	(30)	(114)	(126)	(125)	(53)	(50)
Reserves, Provisions & Exceptionals	(25)	(33)	(201)	(181)	(137)	(85)	(75)
Other Cash Movements	0	25	0	0	0	0	0
Operating Cash flow	(1)	(20)	(338)	(152)	(151)	(5)	23
Colleague shares / incentives	(8)	(3)	(13)	(13)	(13)	(13)	(13)
Undistributed JV Profit & Pension creditor etc	(26)	(17)	8	(21)	(59)	(17)	(14)
Free Cashflow Before Interest and Tax	(38)	(40)	(343)	(186)	(183)	(34)	(4)
Interest	(7)	(11)	(12)	(15)	(16)	(17)	(18)
Tax	19	13	0	0	0	0	0
Free Cashflow	(33)	(37)	(355)	(201)	(199)	(51)	(22)
Other Government funding	N/A	N/A	200	215	170	80	60
Cashflow after funding	(33)	(37)	(155)	14	(29)	29	58

STRATEGIC PLAN BALANCE SHEET

- Under the strategic plan Post Office Ltd forecast the following balance sheet position²:

Balance Sheet (£m)	as at	Mar-11	Mar-12	Mar-13	Mar-14	Mar-15	Mar-16	Mar-17
Assets		118	139	153	169	181	191	197
Working capital	(194)	(156)	(98)	(135)	(135)	(134)	(128)	(127)
Pension Creditor	(661)	(640)	(628)	(691)	(776)	(876)	(944)	(1010)
Client balances	(293)	(201)	(151)	(175)	(153)	(153)	(181)	(207)
Network Cash	550	659	691	702	693	693	682	695
Cash equivalent investments	75	50	50	50	50	50	50	50
Net Trading Funds	(411)	(448)	(603)	(589)	(516)	(539)	(539)	(531)
Net Assets	(436)	(467)	(484)	(484)	(486)	(486)	(421)	(333)
Financed by:								
BOI	(45)	(45)	(45)	(45)	(45)	(45)	(45)	(45)
Capital reserves	461	512	520	529	532	532	466	378
	436	467	484	484	486	486	421	333

BASELINE FINANCIAL STATEMENT

- The strategic plan cashflow represents a significant improvement on the baseline scenario in which no improvements are made to the network. £1B of NSP would still fail to stem the deteriorating financial position of the business and risk Post Office Ltd's ability to maintain the network.

£m	2010/11	2011/12	2012/13	2013/14	2014/15	2015/16	2016/17
Income	910	878	857	823	809	802	791
• Mails	339	329	323	316	311	307	304
• Financial Services	324	306	298	282	282	285	281
– Personal Financial Services	32	36	36	38	39	42	42
– Other FS	292	270	263	244	244	243	240
• Government & ID Services	145	144	135	123	114	106	101
– POCA	71	72	67	61	56	51	47
– Other existing services	75	71	68	62	58	55	54
– New services	0	0	0	0	0	0	0
• Other (inc innovation)	102	100	101	101	102	103	105
Total Costs	(1,027)	(1,043)	(1,041)	(1,052)	(1,087)	(1,075)	(1,069)
• Agents Pay	(480)	(480)	(486)	(451)	(482)	(451)	(449)
• Staff Costs	(252)	(261)	(267)	(277)	(284)	(286)	(285)
• Central & supporting	(295)	(301)	(302)	(302)	(299)	(296)	(293)
• Other Costs of new income	0	0	(6)	(12)	(22)	(32)	(42)
Outcomes							
• NSP	150	180	210	300	350	400	400
• Operating Profit	33	15	26	70	72	126	121
• Free Cashflow	(33)	(48)	(165)	(8)	(51)	(1)	13

² Pension deficit recovery payments are assumed not to be funded by POL after 2011/12 and, therefore, do not impact its income statement and cashflow from 2012/13 onwards.

6. Risks

- Pensions settlement: Post Office Ltd has assumed that the Government will take on the historic pension deficit for the whole of Royal Mail Group as of the 1st April 2012 and that Post Office Ltd's ongoing contributions will not materially increase; there is a risk that this assumption proves not to be the case, in which scenario (where Post Office Ltd has to continue to fund its share of the historic deficit) there is a risk of up to £75m funding shortfall during the plan period.
- New Government Services Income: Post Office Ltd has assumed it will secure £175m of new Government Services income during the plan period. These services will be publicly procured in line with all relevant legislation and that may result in Post Office Ltd being unsuccessful in some tenders. There is, therefore, a risk that this income growth is not secured, or that it is won at lower margin than assumed. Post Office Ltd's maximum exposure to this risk is ~£90m. Post Office Ltd will mitigate this risk by working with Government and in particular the Cabinet Office to move to pilot on new services with a number of Government Departments and Agencies with a view to proving concepts and securing contacts as soon as possible.
- Retail mails revenues: Post Office Ltd has assumed that in return for it delivering the improvements to the customer proposition for retail mails customers, Royal Mail will agree to an intra-business agreement (or in the event of separation, a distribution agreement) at materially the same value as the existing IBA. There is a risk that Post Office Ltd is not able to deliver the level of revenue and contribution from its Mails pillar assumed in the strategic plan, for instance because Post Office Ltd fails to deliver the customer service improvements set out in the plan. This could lead to a revenue shortfall of up to £150m within the plan period. The mitigation of this risk is intrinsically linked to the delivery of the network programme and Mails commercial strategy.
- Innovation: The cumulative income from innovation is £60m from 12/13 to 14/15 which is not yet tied to specific business cases and if it doesn't materialise will reduce POL's profit by £15m. The mitigation for this risk is that Post Office Ltd will monitor delivery of Innovation benefits and take remedial management action if benefits are not forthcoming.
- Consultation and the code of practice: There is a risk that if the code of practice arrangements envisaged for the programme become more onerous than currently envisaged then the costs of implementation will rise, the timescales for delivering changes extend and the likelihood of legal challenge heighten. The mitigation of this risk will be that Post Office Ltd will work with Government and the appropriate consumer body to agree a practical code which gives local communities a proportionate voice in the network changes.
- Completion of network programme: The network programme is highly ambitious, impacting ~7,500 offices during the funding period, and has three main risks. Firstly the scale of the change (effectively twice the size of any previous change programme); Secondly the reliance on some new operating models that have only been piloted and not tried at scale; and Thirdly the ability to find new agents who will operate the new models. The financial impacts of these are impossible to quantify but any of these factors could undermine the network change. Post Office Ltd's management team is experienced in delivering programmatic network change and will track the delivery of the network programme closely as well as incorporating the learnings from earlier programmes into the implementation plan.
- Lack of NFSP support: It is possible the NFSP membership will not support 18 months compensation as previously it was paid at 26 months. If the NFSP are able to generate sufficient public opposition to the change this might undermine the network change or increase the cost of it by ~50% (in excess of £100m). Post Office Ltd has already begun mitigating this risk by consulting with the NFSP executive over the changes and involving them in the strategic planning process.
- Public reaction: The British public have demonstrated great attachment to Post Offices and they might regard the new operating models as a reduction in service. If this opinion generates sufficient momentum it could, again, undermine the network change. To mitigate this risk Post Office Ltd will carefully plan and deliver a communications plan highlighting improvements in customer experience, accessibility and opening hours.
- State Aid approval: If State Aid approval is not obtained for all of this funding over the period (including working capital and the separate 2011/12 funding request) then it is likely that POL would not be able to maintain the network at its current size meaning that POL would be unable to discharge the SGEI obligations that have been entrusted to it or to deliver this strategic plan.
- Additional obligations on Post Office Ltd: If extra obligations over and above those in this agreement are placed on Post Office Ltd that have a material impact on Post Office Ltd's funding then Post Office Ltd's financial viability could be threatened. Post Office Ltd will mitigate this risk by continuing to work with Government on all aspects of the strategic plan to ensure all decisions which might add additional obligations on Post Office Ltd are made with these costs understood.

- Underperforming economy: if the UK economy fails to recover at the pace assumed in the plan Post Office Ltd's commercial operations may fail to deliver the level of contribution towards costs anticipated in the strategic plan.

7. Upsides to the Plan

- New Government Services: there is an opportunity for Post Office Ltd to deliver more new Government Services income beyond planned levels largely by selling the propositions to more Government Departments and Agencies than the core ones assumed in the plan and by re-using consented customer data towards the back end of the funding period.
- Innovation: there is an opportunity for Post Office Ltd if one of the Innovation propositions under investigation can be brought to maturity sooner than assumed and starts to materially contribute to overheads over the plan period. In order to improve the chances of this, Post Office Ltd are assessing a wide range of potential propositions (both in number and diversity).
- Personal Financial Services: there is an opportunity for Post Office Ltd to deliver more contribution from Personal Financial Services than assumed in the strategic plan, for example through:
 - Improved commercial terms with its partners and providers,
 - Higher than forecast sales volumes caused by i) improvements to the sales model and channels or through, ii) effectiveness of Post Office marketing, or iii) market trends,
- Network Programme: there is an opportunity for Post Office Ltd to deliver the network programme under budget through:
 - Lower than assumed development and project costs,
 - More agents opting to convert to new models onsite than assumed reducing the overall amount of compensation, or
 - More Unplanned Closures than assumed, removing these agents from the compensated population.

8. Completion of the programme beyond the funding period

- Post Office Ltd’s full plan for the business runs through to 2016/17, with 2017/18 being the first year of steady state operation.
- There are two main elements of the longer term plan that are not completed by 2014/15 and will continue through 2015/16 and 2016/17:
 - The completion of the network programme and in particular the deployment of a further 4,000 Essentials branches, and
 - The ramp up of new Government services revenues.
- It is critical to the delivery of the strategic plan and to the integrity of the network that Post Office Ltd is able to offer reasonable comfort to agents at the start of the network programme that the programme will be completed in full. Post Office Ltd accepts that it is not possible for Government to provide confirmation of funding beyond 2014/15 at this point.
- Post Office Ltd forecasts the following NSP payments in the years immediately beyond 2014/15:

NSP Breakdown By Year (£m)		
2015/16	2016/17	2017/18
130	80	50*

*£50m is the forecast steady state NSP once the strategic plan is delivered.

- Post Office Ltd forecasts that it will spend £105m in each of the years 2015/16 and 2016/17 on completing the network programme. This will allow Post Office Ltd to complete the implementation of its proposed end state network, made up of the following operating models:
 - Premier branches: 200
 - Main Post Offices (large): 1,500
 - Main Post Offices (medium): 1,300
 - Main Post Offices (small): 1,200
 - Post Office Essentials: 6,000
 - Outreach and Basics +: 1,750
 - Basics: 3,000

Annex 1 – Indicative SGEI Cost Forecast

- The following table sets out Post Office Ltd's indicative forecast of the SGEIs as of the date of this Funding Agreement:

SGEI services	2012/13	2013/14	2014/15
Income	635	637	674
Costs			
Direct	(229)	(257)	(304)
Other operating costs	(295)	(243)	(198)
Capex	(65)	(93)	(93)
Exceptionals	(150)	(133)	(102)
Pension deficit	(17)	(23)	(23)
Total costs	(1,084)	(1,056)	(1,033)
Net Income/(loss)	(449)	(421)	(360)
Reasonable Profit	48	48	51
Net Income/(loss)	(497)	(468)	(410)
Non-SGEI services			
Income	215	229	234
Costs			
Direct	(103)	(130)	(143)
Other operating costs	(67)	(51)	(36)
Capex	(29)	(33)	(32)
Exceptionals	(51)	(48)	(35)
Pension deficit	(6)	(8)	(6)
Total costs	(256)	(271)	(256)
Net Income/(loss)	(41)	(42)	(21)
Contribution	112	99	90
Total - SGEI and non-SGEI products			
Income	849	866	908
Costs			
Direct	(331)	(367)	(447)
Other operating costs	(670)	(603)	(547)
Capex	(114)	(126)	(125)
Exceptionals	(201)	(181)	(137)
Pension deficit	(23)	(31)	(31)
Total costs	(1,339)	(1,328)	(1,288)
Net Income/(loss)	(490)	(462)	(381)

Note: Income lines exclude profit share and cost lines include network cash interest costs

Annex 2 – Network operating models

- The network strategy contains a number of new operating models, each of which plays a different role in delivering Post Office services to different sorts of communities. The table below sets out the models and their roles:

MAIN POST OFFICES			LOCAL POST OFFICES			NEW CONCEPTS
PREMIER	LARGE MEDIUM	SMALL	POST OFFICE ESSENTIALS	OUTREACH / BASICS+	POST OFFICE BASICS	BILL PAYMENT POINTS
<p>Purpose: Main branch driving Personal Financial Services sales, acting as the front office of Government and the focal point of the network in major cities and key towns – our shop window</p> <p>Location/community: City centres, high footfall</p> <p>Customers: Full range of products and services, delivered through an efficient, customer-focused environment with excellent retail standards, product specialists and high levels of automation</p>	<p>Purpose: Service-focused branch delivering a full range of products with clear incentives to capture sales opportunities</p> <p>Location/community: Urban / suburban, high footfall</p> <p>Customers: Wide range of products and services delivered through an efficient, customer-focused environment (both at retail till point and in dedicated PO area) with high retail standards</p>	<p>Purpose: Low-cost, variable-cost access to the majority of Post Office services in urban and rural areas with enhanced customer convenience and opening hours</p> <p>Location/community: Urban and rural, extended hours for urban</p> <p>Customers: Convenient, offering extended hours, local access to a broad range of core Post Office products and services in urban and rural areas over the retail counter</p>	<p>Purpose: Access to Post Office services in rural locations in which other models are impractical or uneconomic</p> <p>Location/community: Rural</p> <p>Customers: Local and reliable access to a broad range of Post Office products and services</p>	<p>Purpose: Expansion of network to provide improved retail mails, bill pay and out of hours access to meet potential competitive threats</p> <p>Location/community: Urban / suburban, extended hours and convenience</p> <p>Customers: Convenient access to Post Office bill-pay and simple mail services over the retail counter in urban areas. Also good for Royal Mail letters business</p>	<p>Purpose: Commercial play with a partner organisation to capture greater share of out of hours and pre-pay bill payment market</p> <p>Location/community: Urban / suburban, extended hours and convenience</p> <p>Customers: Convenient access to Post Office bill-pay services over the retail in all manner of convenience and supermarket stores</p>	

- Each model has a slightly different product and service portfolio designed to meet differing customer and community needs – these are described in the table below:

KEY PRODUCTS	MAIN POST OFFICES				LOCAL POST OFFICES			
	PREMIER 200	LARGE 1,500	MEDIUM 1,300	SMALL* 1,200	ESSENTIALS 2,000	OUTREACH 1,000	BASICS+ 750	BASICS 3,000
<p>MAILS</p> <p>-- Pre-paid ✓</p> <p>-- Mails above 6kg and PFW sales ✓</p> <p>-- Philatelic ✓</p> <p>-- Local Collect ✓</p> <p>-- Mailwork ✗</p> <p>-- P738 work ✓</p>	✓	✓	✓	✓	✓	✓	✗	✗
<p>FINANCIAL SERVICES</p> <p>-- Automated withdrawals / deposits ✓</p> <p>-- Manual banking / Transcash ✓</p> <p>-- Bill payments ✓</p> <p>-- PCFS / travel (no FSS) ✓</p> <p>-- PCFS (in branch sales) ✓</p> <p>-- Postal orders ✓</p> <p>-- Bureau Pre-order ✓</p> <p>-- Euro or Euro/Dollar / Moneygram ✓</p> <p>-- Full Bureau on demand ✓</p> <p>-- NS&I ✓</p>	✓	✓	✓	✓	✓	✓	✗	✗
<p>OTHER SERVICES</p> <p>-- Benefit payments (POCA + Gire) ✓</p> <p>-- Car tax ✓</p> <p>-- ID / Passports / Drivers license ✓ (+AEI)</p>	✓	✓	✓	✓	✗	✓	✗	✗

* The 3,950 legacy model Subpostoffices which Post Office Ltd plan to convert to Essentials in 2015/16 and 2016/17 would mostly have the same product mix as small Main Post Offices

Annex 3 – Key Planning Assumptions

Funding

- State aid clearance sought and obtained for all required elements of plan
- Government provides funding in accordance with the Funding Agreement
- Funding will not be subject to tax
- No net VAT impact from separation

Financials

- No pension deficit recovery payments are assumed from 2012/13 onwards
- Inflation is included at 3.5% pa for staff costs and 2.5% for other costs. Interest rates rise, to 3.8% in 2012/13 and 4.3% subsequently
- The UK economy will not change materially throughout the plan period with modest GDP growth
- Network Subsidy Payment will be received as revenue

Commercial strategy

- The Mails IBA contract at materially the same value
- Mails simplification agreed with Royal Mail to enable pre-paid parcel solutions
- There is no strike action within Royal Mail
- Postcomm approval for increase in mails prices is forthcoming in line with Royal Mail October 2010 application to Postcomm
- ABCUL/credit union costs and income excluded from plan
- There will be no net financial impact from renegotiation of the current joint venture deal with Bank of Ireland affecting Personal Financial Services over the current plan period
- No major changes affecting Post Office Ltd's travel services (in particular travel money and travel insurance)
- Post Office Ltd sign-up two of the remaining big three banks to its cash withdrawal services
- There is no net financial impact from signing up a partner in Bill Payment over the plan period
- New Government Services initiatives will provide Post Office Ltd with ~£175m income over the plan period with a 25% contribution to fixed overheads
- POCA revenue will decline in line with the forecast provided in the POCA contract
- Innovation income will be £60m over the plan period with a 25% contribution to fixed overheads

Network and Delivery strategy

- Government will continue to mandate a network of at least 11,500 branches which meet the access criteria and that there will be no mandated programme of Post Office closures
- New model propositions will be sufficiently attractive to prospective agents to enable Post Office Ltd to recruit the number of agents assumed in the plan; and new Main Post Office agents will match funding for their branch refurbishments
- Project cost assumptions are based on previous management experience of change programmes
- The programme will be "semi-voluntary" in nature, meaning that those agents who have a valid contract in place on 1st April 2012 will have some choice as to when they adopt the new models into their businesses, but that this period will have an end date upon which contract and operating model changes become mandatory (no later than the end of December 2016)
- The National Federation of Subpostmasters supports the compensation policy, in particular the base factor being at 18 months pay
- The changes in the Crown Office network, particularly the staff pay buy-down and franchising are achieved without industrial action
- The level of Unplanned Closures is 150 per annum
- The proportion of off-site conversions is 25% for Main Post Offices and 50% for Post Office Essentials
- The full network programme is communicated to agents at the outset of the programme, and funding will be available for the last two years of the programme (15/16 and 16/17) which fall beyond the period of this funding agreement
- There is no judicial review or other legal challenge to the programme that delays or halts implementation
- There is no change in relevant Government policy
- The Code of Practice is no more onerous than currently and there will be no consultation for on-site conversions

- The cost of services provided to Post Office Ltd by Royal Mail remain materially the same and there will be no material financial impact on Post Office Ltd as a result of the separation
- The cost of any agent gainshare mechanism is excluded