

In Strictest Confidence

POLB05(5th)
POLB 05/70 – 05/91

Post Office Limited

(company no. 2154540)

Minutes of the meeting of the Board
held at 80-86 Old Street, London
on August 17th 2005

Present:

David Mills	Chief Executive
Ian Anderson	Human Resources Director
Alan Cook	Non-Executive Director
Peter Corbett	Finance Director
Ric Francis	Operations Director
Brian Goggin	Non-Executive Director
Graham Halliday	Banking & Financial Services Director
Allan Leighton	Chairman, Royal Mail Holdings
David Miller	Chief Operating Officer
Gordon Steele	Marketing & Direct Sales Director

In attendance:

GRO

Ann Adams

Notes

Consultant – Transformation Programme (for POLB05/75 – 05/76)

Apologies:

Sir Michael
Hodgkinson
Jonathan Evans

Non-executive Chairman

Company Secretary

POLB05/70

MINUTES OF PREVIOUS MEETINGS POLB(05)4TH

- (a) The Board approved the minutes of the Board meetings of 27th April 2005.

POLB05/71

STATUS REPORT POLB(05)57

- (a) The Board noted the report, and in addition:
- (b) Inter-Business Charging Structure: David Mills reported that good progress had been made, and one outstanding issue of importance remained concerning whether the pricing should be on an RPI or RPI minus 1 basis. Peter Corbett stated that the best solution would promote cost efficiency in a way which would allow the benefits to be shared between Post Office Ltd and Group;
- (c) Camelot: David Mills reported that a paper would not now be necessary, because if Camelot failed in its bid the issue would

In Strictest Confidence

end. Post Office Ltd was both a buyer and seller of stock and a buyer of other stock. The Camelot shareholding was thought to be worth £25m, although it was a diminishing asset;

- (d) Cashback to Customer: Graham Halliday reported that complex discussions were taking place with LINK and OFT. If Post Office Ltd was to provide cashback across the network now, it would undermine the positioning of Post Office Ltd as a free provider of cash;
- (e) Ilford Directly Managed Branch: David Miller reported that Ilford Directly Managed Branch had now been vastly improved;
- (f) Credit Card: Peter Corbett circulated a paper containing a financial analysis illustrating the cost to the business of different payment methods. Credit card charges were the most expensive, and cash was cheapest at all levels up to around £150. Peter Corbett would ensure Sir Michael Hodgkinson was provided with a copy of the paper for when he returned from leave.

Action:
Peter Corbett

- (g) Employee Scheme: Graham Halliday reported that there was currently no formal tracking system in place to monitor sales to Bank of Ireland employees. However, preliminary investigations suggested that total sales were less than 100. A formal tracking scheme would be put in place before the next Board meeting.

Action:
Graham Halliday

- (h) Subject to the above mentioned points, all actions were complete.

POLB05/72

CHAIRMAN'S BUSINESS – POLB(05)58

- (a) David Mills had no business to report on behalf of Sir Michael Hodgkinson.

POLB05/73

CHIEF EXECUTIVE'S REPORT

- (a) David Mills reported the following matters to the Board:
- (b) Barry Gardiner: A meeting between the Minister for Competitiveness and Crispin Beale's market research team had taken place on 1st August. The tools and modelling techniques used in market research had been discussed;
- (c) Postcomm: A meeting had taken place with Denise Bagge of Postcomm whose primary responsibility was Public Relations. Initial thoughts were that a very useful relationship could be built with her. A meeting had also taken place with Sarah Chambers and Nigel Stapleton who had made it clear they would be pushing hard to open up the counters business to competition. Allan Leighton stated that this was a more complex area than Postcomm had suggested, and the Board agreed that a legal view of this issue would be investigated. It would also be

In Strictest Confidence

Action:
Gordon Steele

important to establish Postcomm's position on suggested terms of access. Gordon Steele would take this up under the Mails streams work;

- (d) John Roberts: A meeting had taken place with John Roberts who now represented Postmaster Net.
- (e) BITC: A meeting had taken place with Vanessa Strauss of the BITC, as a follow up to the 'Seeing is Believing' visit in Cambridgeshire;
- (f) Scotland: A day had been spent visiting gold branches which had underlined the potential benefits of the 'core and outreach' strategy. Graham Halliday and Ian Anderson had visited platinum and diamond branches. A Colleague Communication Forum had taken place and a dinner had followed with members of the Scottish Assembly who appeared supportive of Post Office Ltd's direction;
- (g) Mentoring Prisoners: Visits would take place to Rochester Young Offenders Prison, and six volunteers had put themselves forward for mentoring.

POLB05/74

BUSINESS PERFORMANCE POLB(05)59

- (a) Peter Corbett provided the Board with a presentation on Period 4 business performance. The Board noted the presentation, and in particular that:
- (b) period 4 P&L after Group Allocation and Pensions costs was a loss of £40.5 million, which was £2.5m favourable to plan;
- (c) income was £0.6m better than budget due to higher postage volumes. Staff costs were £1.3m higher than budget due to higher productivity costs and pay award settlements. Non-staff costs were £1.7m over budget due to higher EDS costs and HomePhone™ costs of sales. These were being offset by lower agents costs (£0.8m) and higher profits posted by First Rate, plus lower Group allocations (£2.0m);
- (d) period 4 YTD P&L before tax was a loss of £50.9 million, which was £13.1 million favourable to budget. The favourable variance was due to the timing of exceptional items, mainly severance (£2.9m) and impairment costs (£5.5m) and lower interest expense (£2.1m);
- (e) the cash flow year to date was an outflow of £93m. This was £97m better than planned due to the reduction in debtors and the on-going reduction in network cash;
- (f) the profit target for this year was a £130.7m loss. The components of this were:
 - (i) an Operating Loss of £79.8m;

In Strictest Confidence

- (ii) a £10.2m adjustment to Profits from Associates and Joint Ventures (due to the adoption of International Accounting Standards);
 - (iii) a £13.6m Pension Funding Adjustment;
 - (iv) £27.1m Group Allocations.
- (g) the Focus Products were £3.6m below plan. Allan Leighton expressed concern at the 'run rate' of the financial services products. Peter Corbett explained that this was in part symptomatic of the strategy of breaking into the financial services market and positioning the products. However, it was acknowledged that there would be difficult times ahead if the assumed future benefits in terms of retention and renewals failed to materialise. The Board agreed that the following additional information would be provided at the next Board meeting to assist their understanding of the situation:

Action:
Peter Corbett

- (i) revenue sensitivity data;
 - (ii) an analysis of how risk would alter the shape of the numbers; both this year and next year;
 - (iii) Financial Services Products renewal data.
- (h) Alan Cook commented that Post Office Ltd's target of selling 1,400 GEBs per week was too ambitious, given that NS&I, who were the market leaders, could only sell a maximum of 1,200 GEBs per week during the 8 week period of their last GEB offer;
- (i) Gordon Steele remarked that despite some initial difficulties with some products, there had been notable successes: HomePhone™ customer sign-ups had now passed the 160,000 mark and were growing at a faster rate than any of the other entrants to the market. The target of 500,000 customers by the end of the year was achievable, and Post Office Ltd could become a major competitor to BT within 5 years. Field Sales Agents had been recruited to help build sales in the Directly Managed Network. Alan Cook agreed this was a useful way forward, as the success of Sales Agents may help to inspire staff.

POLB05/75

STRATEGIC PLAN POLB(05)60

- (a) Peter Corbett provided the Board with a presentation to update the Board on the strategic plan. The Board noted the presentation, and in particular that:
- (b) the dates of key importance were the Royal Mail Holdings Board on September 6th, the submission to the DTI on September 30th, the detailed plan and transformation planning during October to December, and Communication and Execution in early 2006. Allan Leighton requested that the Board further note the date of 14th October, which was when Sir George Bain was expected to complete his report to the Secretary of State;

In Strictest Confidence

- (c) there were three plan scenarios: the old Plan, the commercial plan and the overlay to the commercial plan:
- (i) the old plan essentially represented 'transformation on a shoe-string budget'. It would involve no major change to the network and central costs, and would be heavily reliant on HomePhone™ and POFS income, steady attrition of rural branches, a reduction in headcount of 2500 and 200 branch conversions. The result would be a negative cashflow in year 5;
 - (ii) the Commercial Plan objective was a Return on Capital Employed, and would involve a £300m PBIT turn-around to be achieved by year 5. This would involve dramatic changes, including the closure of 7000 branches, 400 conversions and a 75% reduction in the number of staff;
 - (iii) The 'overlay' to the Commercial Plan was a more politically acceptable commercial plan, the objective of which was for funding not to exceed the current envelope. It would involve lower transformation costs, reduced year 5 profit and a higher working capital requirement for network cash. The result would be a network on 9,135 branches and 3,615 outreach branches. The balance of the mails reserve would be provided for funding up to a maximum of £450m. A working capital loan would be provided of £1.5billion, but the security requirements relaxed.
- (d) after some discussion, the Board agreed that the plans would be submitted to Government.

POLB05/76

TRANSFORMATION PROGRAMME POLB(05)61

- (a) Peter Corbett introduced Ann Adams to the Board who provided an update on the Transformation Programme.
- (b) A review had taken place of the strategic plan, and although it was found to be basically sound the following critical issues had emerged:
- (i) urgency of balance sheet restructuring;
 - (ii) sustainability of new income streams;
 - (iii) heavy fixed costs;
 - (iv) network size and shape;
 - (v) cultural transformation.
- (c) the Post Office Ltd Executive Committee had agreed the scope and structure of the project, and were in the process of recruiting a Programme Director;
- (d) the objective of the programme would be to define and prioritise the total programme of activities required to deliver the transformation, rather than the direct management of all business activities. These activities would be broken down into

In Strictest Confidence

'workstreams';

- (e) The Board agreed the transformation programme should proceed along the lines outlined. Peter Corbett highlighted that the timescales were important and execution would need to start quickly or the projected financials would be put at risk. The Board further agreed that only the top two key consultants should be engaged in assisting the delivery of the programme. David Mills would communicate this decision to the consultants.

Action:
David Mills

POLB05/77 SOLVENCY POLB(05)62

- (a) Peter Corbett reported that the key issues in relation to solvency were to ensure:
- (i) profit and cashflow were at least in line with budget;
 - (ii) the 'route map process' proceeded in line with the agreed timetable.
- (b) profit and cash performance were on track, and were not currently a matter for concern;
- (c) the 'route map process' was proceeding along the agreed line.

POLB05/78 RURAL STRATEGY UPDATE POLB(05)63

- (a) David Miller presented a Rural Strategy Update paper to the Board:
- (b) the Government had requested a report by December 2005 on how innovation could improve the rural network;
- (c) the rural strategy programme team had developed a strategy around three key themes, and a full pilot programme was underway to test these approaches
- (d) Interim findings had suggested that
- (i) rural revenue growth opportunities existed in rural areas, but these would only marginally impact the £150m risk. The emphasis would therefore be on achieving less costly ways of servicing rural areas or withdrawing from them. The proposed 'outreach' channels were cheaper, operationally feasible, better tailored to realistic community needs and command general stakeholder support;
 - (ii) a varying mix of closing the very smallest rural branches and converting to outreach a tranche of larger branches could deliver rural network scenarios with an accompanying annual funding requirement range of £75m to £120m;
 - (iii) if there was to be no funding beyond 2008, the only

In Strictest Confidence

route available to Post Office Ltd would be to close at least 7000 branches;

- (iv) the Board noted the progress being made by the Rural Strategy Programme.

- (e) The Board agreed that the Business positioning to Government should be that:

- (i) if there was no funding agreement post 2008, Post Office Ltd would have no option but to close at least 7000 branches;
- (ii) the alternative was a long-term arrangement with Government to provide specific future rural service provision. Options to implement such an arrangement involved combinations of rural closure and conversion to outreach channels. The extent and pace of change would need to be negotiated with Government;
- (iii) the Rural Strategy would be incorporated at the earliest date into the Transformation Programme in order to ensure a fully integrated approach to the physical network. For example, Urban Deprived provision, DMB provision and the applicability of some of the Rural Programme approaches to other parts of the network as a means of releasing savings.

POLB05/79**IMPACT PROGRAMME POLB(05)64**

- (a) Peter Corbett provided a presentation on the Impact Programme to the Board. It was explained that 'Impact' was an abbreviation for 'Improved Accounting'.
- (b) the objective of the programme was to save costs, replace obsolete back office systems, improve branch and client accounting, improve debt recovery, save time in branches and improve stock control;
- (c) the development costs for the programme were £25m, but the benefits would include savings of £15m per annum in 2006/07; This would be one of Royal Mail Group's biggest IT programmes.
- (d) whilst the programme could not be regarded as state of the art, it would go a long way to modernise and improve the reliability of the systems;
- (e) the rollout was not expected to be 'noise-free', and potential risks included higher call volumes, a consequent impact on service levels, and concern regarding debt recovery. Measures to mitigate these risks were in hand, and included a call centre plan, communication to branches, and stakeholder management. Peter Corbett's analysis suggested that the most significant issues would be around data migration rather than the system itself;

In Strictest Confidence

- (f) planned completion of the new finance system was 24th August 2005. A branch trading pilot would commence on 14th September, and full branch roll-out was planned for 30th November;
- (g) Allan Leighton explained that it was imperative that the roll out dates were achieved and that the programme was completed before the Christmas period;
- (h) the Board noted the presentation and agreed that the roll-out should commence in accordance to the planned timetable.

POLB05/80**CASH IN TRANSIT - UPDATE POLB(05)65**

- (a) Ric Francis provided a presentation to update the Board on the progress of transforming the cash business;
- (b) Cash In Transit was not a core activity of Post Office Ltd, and provided only 2.4% return on £21.5m income. The investment required to remain in the external CIT market could not be sustained;
- (c) the CWU would be likely to strongly oppose exit from the market, as it would be perceived as eroding their powerbase;
- (d) current cash strategy over the next 3 years involved the closure of Dartford and Leeds cash centres, removal of services from 2500 outlets and further Cash Centre Efficiencies. Furthermore, offices would be funded using alternatives to Cash Services, such as Retail side funding and surplus to deficit office supply, and services reduced from 19,000 to 7,000 per week. The use of single man soft skin vehicles was also being investigated, and this would also include the replacement of the S200 cash carrying case;
- (e) Royal Mail were investigating the opportunity of introducing a high value mails product, with a speculative revenue projection of £20m. Post Office Ltd would be in the position to deliver this product, and this may significantly de-risk the exit from the external market and provide redeployment opportunities for surplus CIT staff. A decision would be made by Royal Mail marketing in September 2005. The Board agreed that Gordon Steele would ensure he raised this matter at Group level with Alex Batchelor.

**Action:
Gordon Steele**

- (f) Allan Leighton emphasised that staff culture within cash centres remained an ongoing issue. Ric Francis outlined that the key problems areas were:
 - (i) overtime and rates of pay;
 - (ii) local site management engagement;
 - (iii) poor working conditions and vehicles.
- (g) Ian Anderson added that management did not see development

In Strictest Confidence

of their staff as a priority, and David Mills expressed dismay that there was no robust system of performance management in place.

- (h) The measures which should improve the situation included:
- (i) increased engagement at face to face meetings;
 - (ii) work time learning;
 - (iii) improvements to environment, equipment, security and health and safety;
 - (iv) more effective use of Have Your Say results from cash centres.
- (i) Allan Leighton explained that Royal Mail now had a policy whereby new management appointees could not operate at delivery offices where they had originally worked as postmen. This was designed to break down the culture of favouritism which had a negative impact on staff morale. The Board agreed that a similar policy should operate at cash centres.
- (j) The Board agreed the strategic direction proposed in the presentation.

Action:
Ric Francis

POLB05/81

HEALTH & SAFETY UPDATE POLB(05)66

- (a) Ian Anderson presented the Health & Safety update paper to the Board. The Board noted that:
- (b) significant progress had been made in the reduction of absence accidents and resulting days lost. The number of absence accidents and days lost is expected to have fallen against target by 10% and 37% respectively;
- (c) The headlines for 2005/06 against same period in 2004/05 were as follows:
- (i) absence accidents down by 36% against target – with significant improvements in both the Directly Managed and Network Support sectors;
 - (ii) reportable (RIDDOR) accidents down 5%;
 - (iii) days lost due to accidents (including trauma from attacks on cash in transit crews) down 37%;
 - (iv) Have Your Say results above target of 67% at 69.4% for responses to health and safety questions.
- (d) The current key activities to help offset the risks included:
- (i) NSS line manager face to face health and safety competency training commences in September;
 - (ii) new H & S audit process to focus on knowledge and behaviours not just compliance. Roll out August onwards with key units targeted at onset;
 - (iii) new simpler and more straightforward risk assessment process agreed and ready for launch from September;

In Strictest Confidence

- (iv) sales health and safety measures and redeployment of Work Time Learning modules;
 - (v) Health and safety audits.
- (e) The Board noted the paper, and agreed the current approach to Health and Safety.

POLB05/82**ASSOCIATE COMPANY ITEMS FOR NOTING POLB(05)67**

- (a) The POFS minutes of April 2005 were noted at the Post Office Ltd Board meeting in June 2005. There were no further approved minutes for noting.
- (b) The last FRTS Board meeting was in April and the minutes have yet to be approved by the FRTS Board. There were no further minutes for noting at this time.
- (c) The Board noted the POFS operating plan. Graham Halliday reported that the numbers in the POFS operating plan were higher than in the Bank of Ireland plan to help ensure the City's expectations were met.

POLB05/83**RISK AND COMPLIANCE COMMITTEE**

- (a) Peter Corbett reported that due to the London Bombings which took place on 7th July 2005, the Risk Committee had been deferred until xx September 2005.

FUNCTIONAL REPORTS**POLB05/84****FINANCE FUNCTIONAL REPORT POLB(05)68**

- (a) The Board noted the report.
- (b) There were no further issues raised given Business Performance, Solvency and the Impact Programme had already been discussed in some detail.

POLB05/85**SALES & SERVICE REPORT POLB(05)69**

- (a) The Board noted the report, and also noted that:
- (b) Sales Capability Training: Sales Capability training was now live in the Directly Managed network with all branches undertaking a full hour's training every Tuesday. A CWU ballot had strongly supported a mutually agreed Code of Practice covering sales behaviour, performance management and sales coaching within our Directly Managed branches;
- (c) Sales Agencies: Four Field Sales Agencies have now been appointed, subject to some minor contractual issues. 50 agents

In Strictest Confidence

were operational on a daily basis at the end of July. We anticipate this will rise to around 200 by early September. These agencies are focusing on HomePhone™ in the first instance;

- (d) Credit Card: A comprehensive sales plan is in place for the launch of Post Office Credit Card. The first event brings the entire sales team together in London for a motivational and training day on 17 August;
- (e) Property: Property projects had been completed at Cambridge Directly Managed Branch (DMB) and Pinfold St, Birmingham. The relocation of Sunderland DMB to a less expensive site was on track for completion by February 2006. Lease details were being finalised to enable the merger of Chelsea and Sloane Square DMBs into a new site. £500k had been released for this years Refurbishment programme which would be sufficient to carry out 15 Refurbishments. These would be coordinated with the ISA Postshop rollout;
- (f) Sales Prompts: Allan Leighton reported that he had received several emails complaining that the implementation of sales prompts was confusing for front line staff. The Board agreed that David Miller and Ric Francis would investigate and report back.

Action:
David Miller
Ric Francis

POLB05/86**MARKETING & DIRECT SALES POLB(05)70**

- (a) The Board noted the report and in addition that:
- (b) HomePhone™: Customer sign-ups have now passed the 160,000 mark and were at a faster rate than any of the other entrants to the market including Carphone Warehouse, Tesco and Caudwell;
- (c) Mails: A cross group monthly meeting has been established with Royal Mail Letters and Parcel Force World Wide to review joint progress and ensure that a Group view could be taken of the retail mails programmes. Contract negotiations have progressed well and there were only two issues outstanding;
- (d) Post Campaign: Gordon Steele would be presenting a very important Post Campaign to Alex Bachelor, which would involve the up-selling of First Class mail at Post Office Branches during the run up to Christmas. This activity would benefit the Group as a whole rather than Post Office Ltd directly, and would help push back against the comments from Postwatch last Christmas.
- (e) ISA: A pilot 'Christmas Catalogue' was being produced into Postshops at Directly Managed Branches. The goods would be made available through web and telephone channels and delivered by Parcelforce and Royal Mail Letters. If the pilot proved successful, it would be repeated quarterly next year.

In Strictest Confidence

Action:
Gordon Steele

The Board agreed that the delivery of Christmas Flowers should be verified.

POLB05/87

BANKING & FINANCIAL SERVICES POLB(05)71

- (a) The Board noted the report and in addition that:
- (b) ATM Strategy: A joint Steering Group and project team had been set up to manage this project following the partnership agreement with Bank of Ireland. A press announcement was made on 18th July 2005. The pilot was scheduled for 6th and 7th September, with full roll out would commence in October 2005. Graham Halliday thanked Brian Goggin for his continued support.
- (c) Alliance & Leicester ATMs: These ATMs were currently being replaced, and would eventually not feature in the network. Although a significant number of A&L machines provided free cash, these ATMs were often poorly maintained and not marketed properly.
- (d) LINK: Following LINK's decision to decline application for membership, Post Office Ltd had received an invitation to meet with the OFT and assist with their work on LINK access and governance arrangements. A meeting was scheduled for 16th August, at which the OFT had been briefed on the difficulties experienced in joining LINK. Post Office Ltd now attended the LINK Access Working Group, which was a sub committee of the Payment Systems Task Force (PSTF). Post Office Ltd's representative had ensured the terms of reference of the Group had been modified to include Post Office Ltd's position. If the Working Group failed to fulfil Post Office Ltd's expectations, a complaint to the OFT may yet result.

POLB05/88

OPERATIONS REPORT POLB(05)72

- (a) The Board noted the report, and in addition that:
- (b) Service Specification Programme: For Revision One activity four depots had been carried forward into 05/06. For Revision Two activity, Swansea and Peterborough depots had been implemented, and activity was being progressed on the other depots. The delay on revision one activity had impacted on the 05/06 plan, but remedial action was being taken to recover the situation. An agreement has been reached to fast-track 5 depots (i.e. perform a desk top revision) to try to recover the impact of the revision 1 activity on 05/06 plan;
- (c) Body Armour: An ergonomic assessment had been undertaken for both overt and covert body armour. It was determined that the overt vest was likely to increase the risk of injury for some tasks. The covert vest appears to be less likely to increase the risk of injury but it was highly recommended that the effects of

In Strictest Confidence

heat stress, comfort and hygiene were properly assessed;

- (d) Horizon Network Resilience: The development of a backup network service continued to plan, with Horizon changes entering the testing phase. The service introduction date was planned as April 06, and is expected to make a significant impact on the problem of long-term branch outages, and nearly all outages within our largest 2,000 branches.

POLB05/89

HUMAN RESOURCES REPORT POLB(05)73

- (a) The Board noted the report and in addition that:
- (b) Have Your Say: nearly all measures were scoring marginally better than this time last year. 'I Enjoy Working here' scores were still poor at 61% YTD, down 5% on this time last year. Ian Anderson explained that the results were driven by the Company being good at training, but not so good at the 'hearts and minds' issues. Sales Account Managers had become involved in help improve the results because of the potential effect on sales.
- (c) Industrial Relations: Unofficial action had taken place at Bridgewater over plans to franchise the office.

POLB05/90

SEALINGS POLB(05)74

- (a) The directors approved the affixing of the common seal of the company to the documents set out against item number 101/01 and 136/05 inclusive in the seal register.

POLB05/91

CLOSE

- (a) There being no further business, the meeting was closed.