CONFIDENTIAL

10 DOWNING STREET

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FILE TITLE:	SERIES
Policy	Post Office
	PART: 4
PART BEGINS: 19 JULY 2002	PART ENDS: 5 MAY 05
	CAB ONE:

Labour Administration

PREM 49/4287

CONFIDENTIAL

T.S.O. Order No. N0064510 3/98 C5 59064

PART

CLOSED

DATE CLOSED	5 MAY 2005

Series : **POST OFFICE**

File Title : **POLICY**

Part : **4**

Date	From	To	Subject	Class	Secret
30/07/2002	SS/WAP	PM	Universal Banking - Update	R	
31/07/2002	PD(GN)	PM	Universal Bank	R	
21/08/2002	MS/DTI	DPM	DA committee on post office policy	C	
27/09/2002	Cab Off	PM	Universal Bank	C	
02/10/2002	DTI	DTI	Royal mail - insolvency and dispute with Postcomm	C	
02/10/2002	DTI	DTI	Royal mail - POSTCOMM price controls proposals	C	
07/10/2002	PPS	Cab Off	Universal Bank	C	
01/11/2002	PD(GN)	PM	Post Office Network: Update	R	
04/11/2002	SOC	PM	Universal banking	C	
20/12/2002	SOC	PM	Universal Banking	R	
27/01/2003		PD(GN)	From Lord Sawyer , Independent Review of industrial relations in Ro	U	
27/02/2003	SS/DWP	PM	Universal Banking	U	
28/02/2003	Cab Off	PM	Universal Bank (UB)	R	
07/03/2003	PD(GN)	PM	Monday's meeting with the Postmasters Federation	R	
19/03/2003	PM		To Colin Baker: National Federation of Sub Postmasters	U	
26/03/2003		HMT	VAT and postal services	R	
26/06/2003	DWP	PD(GN)	Unviersal Banking Programme	U	
22/07/2003	MWP	EWS	Royal Mail's decision to transfer Freight from rail to the roads	U	
01/08/2003	ss/dti	PPS	Letter of Recommendation for Postcomm	R	
05/08/2003	PD(OJ)	DTI	POSTCOMM	R	
12/08/2003		PM	Letter from Gerald Kaufman - The post Office	U	
29/08/2003	PD(GN)	PM	Royal Mail: Industrial Action	R	
05/09/2003	PD(GN)	PM	Royal Mail Dispute	R	
08/09/2003	PD(GN)	PM	Settlement re pay?	C	
09/09/2003	PD(GN)	PM	Post Office & Gerald Kaufman	U	
12/09/2003	PD(GN)	PM	Meeting with PO leaders moving mail by road	C	
24/10/2003	ss/dti	PPS	Chair of Postal Services	R	
13/11/2003	Cab Off	dpmo	Managing Post Office Contracts	R	
10/12/2003	SS/WAP	PM	Universal Banking Update	R	
07/04/2004	PD(GN)	PM	Royal Mail: Future Ownership Options	C	
06/09/2004	ss/dti	DPM	Government Support for the Rural Post Office Network	U	
15/09/2004	ss/defra	DPM	Government support for the rural post office network	U	
16/09/2004	DPM	ss/dti	Government Support for the Rural Post Office Network	R	
22/10/2004	PD(GN)	PM	Allan Leighton and the Future of Royal Mail	C	
26/11/2004	ss/dti	PM	Royal Mail Chair	R	
02/12/2004	PPS	DTI	Re Appointment of Allan Leigton	R	
20/01/2005	SS/DWP	PM	Update on Universal Banking	U	
02/02/2005	PD(RB)	PM	Universal banking - phasing out of order books	R	
07/02/2005	PM	SS/DWP	(PM) Universal Banking	C	

Can the person who receives the cheque take it to the P.O. & cash it direct, or if no bank a/c? If so, that should be publicised & may be a way to...

Copy → Mary C + Catherine R

From: Ramil Burden
Amber Batool

Date: 2 February 2005

PRIME MINISTER

cc: PS/ Alan Milburn
Jonathan Powell
Sally Morgan
Ivan Rogers
Geoffrey Norris
Gareth Davies
Susan McLaren

UNIVERSAL BANKING: PHASING OUT OF ORDER BOOKS

Following our previous note you expressed concerns about the phasing out of order books. DWP are confident they have in place systems to ensure there are no significant problems. We recommend that you write back to Alan Johnson saying we must remain alive to potential problems, especially in relation to lost or missing cheques, and that you want him to continue to have Ministerial responsibility for universal banking. A draft is attached.

THE PHASING OUT OF ORDER BOOKS

The phasing out of order books (which are basically a six-monthly batch of cheques) was announced in May 1999 with the aim of encouraging as many benefit recipients as possible to have their benefits paid into bank accounts or Post Office Card Accounts (POCAs). By the end of February order books will have been phased out. The objective was to save taxpayers money, as payment by order book is much more expensive, and to increase financial inclusion. To reverse the decision to phase out order books now would undermine the objectives of the project and put the business case for it at risk.
People with POCAs or accounts at participating banks can still draw their benefits in cash at the Post Office, though they have to use a card and PIN number.

DWP have succeeded in converting most (over 90 per cent) customers to direct payment. However some 200,000 pensioners have refused direct payment and 400,000 have simply failed to respond to DWP's approaches. A further 700,000 people on disability or lone parent benefits are in the same position. With the phasing out of order books, these people will be paid by weekly or fortnightly

cheques sent individually through the post. DWP estimate that, in total, some 1.7 million cheques will be sent out a week from February (because some people will get more than one cheque.)

The conversion process has gone smoothly so far, but it is at an early stage. This issue needs to be managed by making a very new system usable for those who are blind or visually impaired and providing a reliable service to people receiving cheques, particularly if it gets lost in the post.

BLIND AND VISUALLY IMPAIRED CUSTOMERS

DWP are putting arrangements in place to help blind and visually impaired customers, including the use of tactile markings on cheque notification letters and specially designed machines for POCA's which make them easier to use. Your letter to Alan Johnson flags this as a particularly important issue that DWP needs to keep on top of.

MISSING CHEQUES

DWP estimate that they will receive enquiries on about 0.25% of cheques (e.g. non delivery, loss or damage). This means that from February we should expect about 2,000 pensioners a week to have some sort of problem (though only some will be serious). To manage this DWP are now:

- Monitoring the number of enquiries about delayed or missing cheques and producing weekly reports. They are also monitoring the local, regional and national press for any sign of a story taking off;
- Ensuring that pensioners get paid in cash on the same day they would normally receive their cheque if they want it;
- Making arrangements for cheques to be collected from the Post Office in the event of a postal strike.

We also need reassurance that pensioners are being informed how to report problems with cheques. DWP say that they should phone the Pension Service, but it is not clear that this message is being given explicitly. DWP also need to make sure that Post Offices know how to deal with a pensioner quickly and efficiently if they say their cheque has not arrived. Your letter to Alan Johnson emphasises these points.

THE BUSINESS CASE FOR UNIVERSAL BANKING

The assumption in September 2002 was that the programme would result in savings of £700m, but DWP currently forecasts that the actual savings may be in the region of £100m. The OGC Review highlighted the potential risk of a worst case scenario in which the business case would actually show a net loss. The OGC suggested a stock take of the business case after 31 March when the position would be clearer. In your letter to Alan Johnson you should highlight this issue and ask him to report back in early April on the post closure review of the business case.

RAMIL BURDEN **AMBER BATOOL**

DRAFT LETTER TO ALAN JOHNSON

Thank you for your letter of the 20 January updating me on universal banking. This has been an important and complex project and I am grateful for the hard work that you, Misc19 and officials have undertaken to make this project successful.

The universal banking programme is entering an important stage and I would like you to retain Ministerial responsibility for its delivery. I agree that the focal point should be located in the Department of Work and Pensions, but it will be important for this work to retain a cross departmental approach and to work closely with key stakeholders.

I note your comments on the high number of cheque payments and share your concerns. Aside from the inevitable pressure that this is placing on the business case, this method of payment does little to improve the financial inclusion of disadvantaged groups and will no doubt cause some anxiety to more vulnerable people.

I agree that it is important to reduce the numbers of cheque payments and would like to be updated on your progress in tackling this issue by the end of February by which time order books will have been phased out. This should include the numbers affected, the groups affected, the strategy to tackle fraud, the costs and the communications plan.

I trust that you will reassure yourself that robust systems are in place to ensure that all customers, and especially the more vulnerable such as pensioners and the blind and visually impaired, will be able to receive their benefits on time and with the minimal of inconvenience. In particular we need to ensure that Post Offices are geared up to help pensioners as appropriate and that people receiving cheques know what to do and who to contact if they do not receive them on time.

In addition to this, I would like to be updated on the post closure review of the business case in early April. This will require the development of a strategy for reducing the volume of cheque payments and Post Office Card Accounts over time, which if successful should result in significant savings to government. It will be vital to have clear ongoing ownership of the business case.

It will be important to manage the end of the programme, especially in February, to meet the concerns of the Post Office and the public. Given the timing, this will need to be supported by a strong communication strategy.

I am copying this letter to Misc19 and Sir Andrew Turnbull.

PRIME MINISTER

UPDATE ON UNIVERSAL BANKING

Summary

Universal banking has been very successful, but I have concerns about the number of customers we will be paying by cheque. After the formal closure of the universal banking programme, if you agree, I should continue to have cross-Government responsibility, supported by a "focal point" in DWP.

Background

1. In 2001 you asked Alistair Darling to take overarching responsibility for the move to Direct Payment of pensions and benefits, alongside the introduction of new banking services by Post Office Ltd, to ensure that all involved worked together to deliver our commitment that pensioners would still be able to pick up their benefit in cash from the Post Office. You also set up a Cabinet Subcommittee (MISC19) to oversee that work. I have now inherited that responsibility, including the chairmanship of MISC19, and I thought you might like an update on progress as we move into the potentially difficult final stage of conversion]

2. I was involved as a DTI Minister right at the outset of the development of universal banking at post offices, and the first thing that struck me on coming back to the subject is that it has been a remarkable success, which few would have predicted in 2001. I would like to pay tribute to Andrew Smith for overseeing the successful introduction of universal banking services, on schedule, in April 2003.

3. The overall objectives of the universal banking programme were not only to modernise the payment of pensions, benefits and tax credits, but also to increase financial inclusion, **and** to provide a platform of opportunity for Post Office Ltd to develop new business to replace order book encashment.

Progress

4. The paying departments – DWP, the Inland Revenue and the Northern Ireland Social Security Agency - are now nearing the completion of the programme to convert customers from payment by order book to payment into an account. 4 out of 5 customers are now paid this way. In the next few weeks, I expect to be able to announce that we have met our PSA target (to pay 85% of customers by Direct Payment) nearly 12 months early. I expect that 94% will be paid into an account by April 2005 – comfortably exceeding the published target.

5. We have invited 13.5 million benefit customers and pensioners to convert to Direct Payment. To date, around 10 million bank account details have been returned, including almost 3 million Post Office Card Account (POCA) details. Over 4 million POCAs have been opened. We are collecting account details from the remainder at the rate of 100,000 a week. Research shows that customers are finding new accounts easy to open, are happy with the information they get and nine out of ten like being paid by Direct Payment.

6. Order books are now being finally phased out – they will have gone by the end of February. Any customers who have not provided bank account details when their last

order book expires will automatically receive their payment by cheque. The current forecast is that we will be issuing some 1.7 million cheques a week from the Spring at a cost of around £120m a year (including the cost of fraud associated with cheque payments). Payment by cheque is the most expensive and fraud-prone method of payment and I want to get that number down over time. My department is also undertaking urgent work to strike the right balance of risk between tackling fraud and protecting vulnerable customers.

7. I am conscious that any activity to reduce cheque and POCA numbers could give rise to presentational difficulties with the Post Office lobby and stakeholder groups and I would not, therefore, consider taking any action until after we have completed the existing migration programme in the late Spring/early Summer.

8. Communication will be important during this final transition period. We have to deal with those people who cannot, or do not not want to be, paid into an account – even a POCA . Some would have liked to keep their order books, but that is no longer an option. Chris Pond and DWP officials are ready to counter potential negative activity, the timing of which could be very significant. In the meantime, our focus is on converting as many people as possible in order to limit the most expensive method of payment – cheque payment.

Closure of the universal banking Programme

9. A team from the Office of Government Commerce (OGC) carried out a further review of the universal banking Programme in October. They confirmed that the Programme is headed towards delivery success by 31 March 2005. The OGC felt the Programme could be brought to a close as a formal Programme after this date but recommended that, as Secretary of State for Work and Pensions, I should continue to take lead Ministerial responsibility and I hope you are able to reaffirm this.

10. In terms of official level responsibility, the OGC recommended that a new Focal Point be established to manage residual universal banking and Direct Payment issues. The OGC were keen to ensure continuity for a period involving some of the individuals currently holding key positions in the programme team. Tony Kuczys, the universal banking Programme Director, will lead the Focal Point and will provide the continuity required.

11. The OGC Team highlighted a potential risk of a worst case scenario in which the overall business case could show a net **cost**, and suggested that there should be a stock take of the business case after 31st March when we will be in a much better position to say whether this is an issue. We know that the higher volumes of cheque and POCA than originally forecast will increase the costs to the business case but overall we are still forecasting a positive outcome on the business case of around £100m, subject to a considerable margin of uncertainty. Following the stock take, arrangements will need to be made for taking forward any residual issues, which will essentially be about reducing the volume of cheques and POCAs, decisions on the renewal of the Card Account Contract, and achieving spending review savings. This will require the development of a strategy for reducing the volumes of cheque payments and POCA over time, which should, if successful, result in significant savings to government.

Conclusion

12. Direct Payment has been highly successful and the new system is proving popular with our customers. The challenge over the next year or so will be to move customers

from expensive methods of payment (POCA and cheques) to payment into a bank account. This will allow us to maximise savings.

13. I am copying this minute to members of MISC 19 and to Sir Andrew Turnbull.

A. J.

life

SUBJECT
MASTER
Filed:

10 DOWNING STREET
LONDON SW1A 2AA

THE PRIME MINISTER
PERSONAL MINUTE

SECRETARY OF STATE FOR WORK AND PENSIONS

Thank you for your letter of the 20 January updating me on universal banking. This has been an important and complex project and I am grateful for the hard work that you, Misc19 and officials have undertaken to make this project successful.

The universal banking programme is entering an important stage and I would like you to retain Ministerial responsibility for its delivery. I agree that the focal point should be located in the Department of Work and Pensions, but it will be important for this work to retain a cross departmental approach and to work closely with key stakeholders.

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BL

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I am copying this letter to Misc19 and Sir Andrew Turnbull.

Tony

7 February 2005

MATRIX

1. Matrix
2. File.

GD cc CO CM SPM

PRIME MINISTER

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A J
20th January 2005

Restricted - Policy

file
not on Matrix

10 DOWNING STREET
LONDON SW1A 2AA

From the Principal Private Secretary

2 December 2004

Dear Matthew,

RE-APPOINTMENT OF ALLAN LEIGTON

The Prime Minister was grateful for your Secretary of State's recommendation to re-appoint Allan Leighton as Chairman of Royal Mail. The Prime Minister is content with the recommendation.

I am copying this letter to James Bowler (HMT) and Sir Andrew Turnbull.

Yours ever,

IVAN ROGERS

Matthew Hilton, PPS DTI

RESTRICTED – APPOINTMENTS

GN cc: AR JF Appts.

dti

PRIME MINISTER

I am writing to recommend the reappointment of Allan Leighton, for a period of three years, as Chair of Royal Mail Holdings plc.

Allan has done a remarkable job in returning Royal Mail to profit over a short space of time. The recently announced half-year results show a profit of over £200 million, with the company expecting to meet the Renewal Plan target of £400 million profit by the end of this financial year (31 March 2005).

Royal Mail is now on a more sound financial footing and in a greatly improved position to meet the challenges of the future. While the Urban Post Office Reinvention programme and failure to meet Quality of Service (QoS) targets have been political hot topics, I am confident that Allan and his Executive Team have concentrated on the right issues to this point. The reinvention programme will provide us a more sustainable PO Network and the trend for QoS figures for next day delivery of first class mail has been improving in recent months. We will keep an eye on relationships with the Trades Unions but I hope that the appointment of Margaret Prosser to the Board will help in this area.

The company, however, cannot rest on its laurels. We are in the process of discussing a new five-year Strategic Plan to 2011. There are many challenges ahead for the company – not least the introduction of full competition in 2006 – but I believe that Allan Leighton is the best Chair to maintain the momentum we have seen in the last three years.

I hope that you will endorse this recommendation. Detailed terms and conditions for the next 3 years are still being discussed with Allan Leighton (including his other non-executive appointments) but, having consulted the Chief Secretary, I propose to increase the remuneration package by £50k to £250k, with the balance weighted heavily in favour of a high performance related bonus.

I am copying this letter to the Chancellor and to Sir Andrew Turnbull.

P H
Department of Trade and Industry

26 November 2004

JW11386

THE NATIONAL ARCHIVES

DEPARTMENT/SERIES PREM 49 PIECE/ITEM 4287/1 (one piece/item number)	Date and sign
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Use the card for one piece or for each extract removed from a different place within a piece.

Enter the department and series,
eg. HO 405, J 82.

Enter the piece and item references, .
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Post Office

RESTRICTED

DEPUTY PRIME MINISTER

OFFICE OF THE
DEPUTY PRIME MINISTER
26 Whitehall
London
SW1A 2WH

Tel: 020 7944 8623
Fax: 020 7944 8621

The Rt Hon Patricia Hewitt MP
Secretary of State
Department of Trade and Industry
1 Victoria Street
London
SW1H 0ET

MH
cc MMG
SPM
GN
RB

16 September 2004

Dear Patricia

GOVERNMENT SUPPORT FOR THE RURAL POST OFFICE NETWORK

You wrote to me on 6 September, copied to DA colleagues, seeking DA clearance for proposals for future Government support for the post office network after 2006. I am writing to give you clearance to proceed as you requested.

You explained that you propose to announce the extension of transitional funding from 2006 to 2008, together with the commitment to continue the no avoidable closures policy until more information from pilots has been secured.

Replies were received from Margaret Beckett, Paul Boateng and Ross Finnie. Margaret agreed that now was not the time to make decisions on the future of the network and she supported your proposal. However, she felt that this proposal could only be an interim solution. She asked for her officials to be kept closely involved.

Paul was content for the announcement to be made as you proposed. However, he commented that the extension you proposed must be the final funding extension before a long-term plan for the rural network is adopted and put in place. Also, his agreement to funding the network in the way you propose applies only until 1 April 2008. He also felt it was important that the rural retail review proposed should not proceed on the basis of any assumption of ongoing funding or of numbers of post offices.

Website: www.odpm.gov.uk
Email: john.prescott@odpm.gsi.gov.uk

Ross also agreed with your proposals. However, he was concerned that there are very few pilot activities supported by the Flexible Fund in Scotland. He also commented that he hoped the group you propose to set up on access to post office services would take a broad view for example, in considering access to services.

No other colleague commented. You therefore have clearance to proceed as you proposed, subject to the comments above.

I am copying this letter to the Prime Minister, members of DA Committee and Sir Andrew Turnbull.

JOHN PRESCOTT

020 7238 6465

Nobel House
17 Smith Square
London SW1P 3JR

Telephone 08459 335577
Email secretaryofstate@defra.gsi.gov.uk
Website www.defra.gov.uk

defra
Department for Environment
Food and Rural Affairs

GN
cc: RB
MH
VB

The Rt. Hon John Prescott MP
Deputy Prime Minister
26 Whitehall
London
SW1A 2WH

15 September 2004

From the Secretary of State
The Rt Hon Margaret Beckett MP

Dear Deputy Prime Minister

GOVERNMENT SUPPORT FOR THE RURAL POST OFFICE NETWORK

I have seen a copy of Patricia Hewitt's letter of 6 September seeking agreement to a further £300 million of funding to support the non-commercially viable element of the rural post office network until April 2008 and to the steps to be taken towards a final decision in March 2006.

The rural network plays an important role in our rural areas, socially and economically. We have already discussed and I agree that now is not the time to make decisions on the future of the network. While Postcomm's advice is helpful in shedding some light on the issues, it would be premature to take such a critical decision before we have all the information we need, particularly from Post Office Ltd's pilot programme. I therefore support Patricia's proposal to extend our current support for a further two years.

But this can only be an interim solution. We will need to take some difficult decisions in 2006. I accept that the current network is not sustainable and will need to be scaled down. This will be hard for rural communities and in particular people who rely on post offices for their services unless we can engage local people in coming up with locally owned solutions and promote

the ideas of co-location and co-delivery of services which have been endorsed so strongly by DA(RR). In parallel with this work within Government we also need to promote the local engagement and acceptance of the need for different ways of doing things. There are already examples of communities pulling together to keep post offices services in their villages and innovative ways of delivering services are emerging throughout the country. POL's pilot work will allow us to learn from these and build on them as we move forward to a more responsive and flexible post office network. Patricia and I agreed that it would be helpful to promote the debate once she had made the announcement which she now proposes to make this week. As we agreed this was discussed further by Alun Michael and Stephen Timms and Alun tells me that many rural stakeholders now recognise the value of such an approach. I suggest he and one of Patricia's junior Ministers discuss this with the chairs of the Regional Rural Affairs forum who I want to see play a greater role as set out in my statement in July in the context of the paragraph in Patricia's letter headed 'rural retail'.

Before we make our final decision on the long term future of the network itself, we need to understand better the economic contribution that the post office makes, how services could be delivered more effectively and how the needs of the most vulnerable will be met. We will also need to play in the response of stakeholders to these difficult issues. These questions are very similar to those that Defra faces in relation to rural services more generally and I see the issue of post offices as part of that larger picture of access to services, particularly cash and retail services. I therefore agree that we need a cross-departmental group, led by DTI, and including the Devolved Administrations, to take this important work forward.

I am content with the rest of Patricia's proposals but would like my officials to be kept closely involved, as they have been, particularly with POL's pilot activity.

I am copying this letter to the Prime Minister, members of DA and Sir Andrew Turnbull.

Janice Kew

pp **MARGARET BECKETT**

(Approved by the Secretary of State + signed in her absence)

dti

6 September 2004

The Rt Hon Patricia Hewitt MP
SECRETARY OF STATE
FOR TRADE AND INDUSTRY

GN
CC RB
MH
VB
Arrg

Rt Hon John Prescott MP
Deputy Prime Minister
26 Whitehall
London
SW1A 2WH

Dear John,

GOVERNMENT SUPPORT FOR THE RURAL POST OFFICE NETWORK

Summary

DA committee agreed the current strategy for sustaining the rural post office network when it met in November 2002 – that £450m of funding should be made available to support the network and ensure no avoidable closures until April 2006 – and asked me to come back with proposals for future Government support for the network post 2006. I should be grateful if any comments could reach me by 14th September at the latest.

The rural post office network continues to be unsustainable commercially. Many individual outlets are underused, and the nature of the Post Office's business and the needs of the rural communities it serves are changing. How and where people access services is changing and it is not clear that the present network best meets those changing needs. A solution for the longer-term will need to take these changes fully into account. Pilot activity to test new ways of ensuring appropriate access to post office services is under way but it is too early to draw conclusions from this. It is therefore not the right time to take decisions about the long-term future of the rural network. A decision on funding beyond 2006 does, however, have to be taken now as we shall shortly have to notify the company of the ending of the current arrangements on 31st March 2006, for which we are contractually bound to provide 18 months notice.

I am writing, therefore, to seek your agreement that, subject to securing the necessary state aid clearance, £300m of funding to support the element of the nationwide network

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of post offices serving rural communities that is not commercially viable should be made available for a further 2 years from April 2006 until April 2008. I propose, however, that the 'no avoidable closures' policy should be maintained beyond April 2006 only until we have the information necessary to take a long-term decision on the network and not necessarily, therefore, until April 2008.

With the agreement of the Chief Secretary, my officials have reached outline agreement with the Royal Mail so that once again funds on Royal Mail's balance sheet will be made available to cover the costs of maintaining the rural network until April 2008. The short term extension to the current funding arrangements will allow us to keep in place our policy to maintain the network until lessons from the pilot activity emerge and better informed longer term policy decisions can be taken. Given the long notice period required by the company for the ending of or changes to funding arrangements, and the fact that the results of pilot activity will be with us within the next 18 months I anticipate that decisions on the longer term, and work begun on its implementation, will be taken in 2006.

If DA Committee is content, I propose to announce the extension of transitional funding from 2006 to 2008, together with the commitment to continue the no avoidable closures policy until more information from pilots has been secured. We have a very limited window of opportunity to make this announcement and my intention is to make a written statement on 16th September.

Background

A background paper on the rural network, which sets out the basis on which the current funding arrangements were agreed and sets out the challenges faced by the network, is attached at Annex 1.

As well as recommending that the Government should support the rural network in the first instance until 2006, the Performance and Innovation Unit (PIU) report on modernising the post office network, published in June 2000, called on the Postal Services Commission (Postcomm) to work with key stakeholders to develop a shared understanding of the role that post offices should play in the longer term and to advise the Government on the main options for the policy framework after 2006. That advice, which was submitted to the Government last July, has informed our work since then to examine and evaluate future policy options. A summary of Postcomm's main findings and recommendations is attached at Annex 2.

Postcomm's findings suggest, for the longer term, that the reasons for the Government supporting the rural network should be carefully reviewed and that the nature of the support should change. But it recognises that such changes must be well informed and that further work will be necessary. It highlights that pilot activity to identify and test new and more cost effective ways of maintaining access to post office services is at an early stage, and that it will be important for the Government to take account of this work when longer term decisions are taken. It also highlights the need to find alternative ways of ensuring that the most vulnerable members of our rural communities can continue to access services currently supplied by post offices.

Postcomm also recommends that the policy, imposed on POL by the Government, of preventing avoidable closures of rural post offices should not continue beyond 1 April 2006, when our current policy would end if it is not renewed. Whilst I accept much of the Postcomm report I believe that we will be better placed to take a decision on the long-term future of the network, including whether the current policy on avoidable closures should continue beyond 2006, when we have more feedback from the pilot activity now being undertaken by POL.

I therefore propose to ask POL for a report on the pilot activity and its implications for future access to post office services by the end of 2005. My intention is to review our policy on avoidable closures after 2006 when we have that information. At this stage I suggest that we agree to maintain it, in the first instance to April 2006, subject to further review.

I should stress that the extension of funding to April 2008 need not hold up progress on modernisation of the rural network once the way forward is clear. For example, if it becomes clear from the pilots that the network can safely be restructured then I will return to DA Committee to make a recommendation to do so.

The announcement that we are not guaranteeing the extension of the 'no avoidable closures' policy until April 2008 will of course require careful handling. A draft statement and Q and A is attached at Annex 3. This is work in progress and my advisers and officials will be working on it further in the lead up to the announcement.

Detail

The main driver in favour of a short-term extension to existing funding is the time required to learn lessons from pilot activity. A key element of the funding package that the Government has made available to support the rural network is the £25m funding for pilot projects to test innovative ways of delivering post office services. Only a handful of pilot projects are under way so far, and it is too early to predict which have real potential to deliver cost-effective access to services for the future. If decisions on the future of the rural network were taken now, the Government would risk criticism for failing to allow proper testing of the alternatives. Before decisions are taken we should press POL to drive forward the pilot activity with a view to having detailed and widespread information on the costs and benefits of different ways of providing access to services.

There are a number of other advantages to extending the existing financial support in the short term:

- Decisions on the long-term future of the rural network would be better informed if they could be taken after benefit payment transition is completed in 2005. The Government is committed to support the post office network through the difficult transition to direct payment of benefits. DWP's transition programme is not due to be completed until April 2005. It is too early to say now what proportion of benefit recipients, once their benefits are paid directly into their accounts, will continue to use the post office to collect them in cash. It is also too early to predict accurately the impact on POL revenue.

- POL's main future business focus is on banking and financial services with some 21 million current account holders now able to access their cash at post office counters. But it is too early to assess the full commercial potential of POL's new banking and financial services. Decisions on the long-term future of the rural network would be better informed if the outcome of these developments in banking and financial services. How well the services perform will affect the future viability of rural post offices.

- Some of the future options for the rural network could involve a planned programme of closures similar to that currently under way in urban areas (i.e. urban reinvention). Lessons are still being learned from the implementation of the urban reinvention programme, which is not due to be completed until 2005. It is therefore also desirable that urban reinvention should be completed, and the lessons learned, before decisions on the long-term future of the rural network are taken.

Some decisions, however, need to be taken now. A decision on funding beyond 2006 is necessary now under the terms of the agreement entered into by the Government with Royal Mail and Post Office Ltd. It is important to maximise business certainty for to the thousands of dedicated individual. Clarity over the future of the rural post office network is crucial also for those living in rural communities who depend on their post office for services such as access to pensions and benefits, cash, bill payment, stamps, letters and parcels.

We also need to ensure that POL is directed to drive forward with further pilot work and instructed to report on the pilot activity by the end of next year. We have an opportunity now to shape this work, signal to POL the type of potential solutions that are likely to be attractive to us and that we would like to see tested. Extension of the funding will provide an opportunity to fine-tune the definition of the policy on preventing avoidable closures in the light of experience and to address the concerns raised by Postcomm.

Marginal closure cases

In the immediate term Postcomm's main concern about the 'no avoidable closures' policy is that it can lead to post offices being saved or re-opened where it is clear that customer numbers have dwindled to levels far below what is sustainable in the longer term. I believe that this concern can be addressed pragmatically.

First, under the present policy on closures I propose to amend the definition of an unavoidable closure so that it takes into account circumstances where there is no prospect of a viable future for a post office because of low and declining demand for those services in an area.

This adjustment will ensure that those charged with maintaining the rural network focus on maintaining access to post office services, taking account of local circumstances, rather than seeking to sustain a traditional post office outlet at any cost. This is important in a small number of cases where change is forced on the business (e.g.

though the resignation or retirement of a sub-postmaster) but the volume of transactions in that particular location is extremely low and local interests would be better served by seeking alternative ways of maintaining access to service for a small number of remaining customers. The effect will be that whilst POL will not be allowed to initiate any rural closures, where change is forced on the business, POL will have sufficient flexibility to allow for innovative and sustainable solutions to maintaining access to post office services where it is clear that a traditional outlet cannot be sustained.

Our current policy encourages pilot activity to trial more efficient ways of maintaining access to services for rural communities and the Post Office has enormous flexibility on the scope and scale of the pilot activity it can undertake. In particular closures are *not* proscribed if those closures are a necessary element of the pilot activity; for example, closing existing offices in order to trial a hub and spoke arrangement. I propose that this should continue to be the only scope for POL to make proactive closures, with the expectation that this will be on a limited scale.

I would be grateful for agreement from DA colleagues that my officials should negotiate the detailed arrangements with POL with a view to ensuring that the freedom for POL to close offices before 1st April 2006 is limited to a small number of cases at the margins where it is clear that the use of the post office in a particular location has collapsed.

Rural retail

I have concluded, following discussions with Margaret Beckett, that access to post office services needs to be viewed as one element of a broader issue for those living in rural communities and that the issue deserves further consideration. Many rural communities are too small to sustain a shop or a traditional post office so innovative solutions are needed, perhaps based on finding better ways to get people to and from viable local retail services rather than trying to maintain a retail presence in every small community.

I have therefore asked my officials to work closely with Defra, ODPM, the devolved administrations and Treasury colleagues over the coming months to ensure that work on future access to post office services is co-ordinated with wider work that Defra and the devolved administrations have in hand to ensure access for those in rural communities to cash and retail services.

Publishing Postcomm's advice

The question of whether Postcomm's advice to the Government should be made public must be addressed. This advice was submitted to the Government in confidence, but on the understanding that it should at some point be published. We agreed with Postcomm that publication should be delayed until the Government was ready to respond. Subject to your agreement to my proposals we will shortly be in the position to respond and I propose to agree to Postcomm publishing their advice subject to the necessary excisions of commercially sensitive information.

Conclusions

The support arrangements for the rural post office network cost the Government up to £150m a year. The challenge now is to find ways to maintain appropriate levels of access to post office services for those in rural communities in the most cost efficient way. POL's programme of pilot activity, which the Government is supporting, will help to ensure that properly informed decisions could be taken at the appropriate time on how this might be achieved.

In the light of the evidence already available to us about the low level of use of many rural post offices it is clear that we need to be prepared to contemplate some tough and innovative decisions about the long-term future of rural post offices. I want to ensure that we use to maximum effect the time afforded by the proposed extension of existing arrangements so that when the longer-term decisions are taken they are properly informed.

With the agreement of the Committee I propose that:

i. Subject to securing the necessary State Aid clearance, which DTI should commence work on now, the Government should agree to continue to meet the cost of maintaining the non-commercial part of the rural post office network from April 2006 until April 2008. I have agreed with the Chief Secretary and the company that the additional funding necessary to do this will be funded from the same source as the existing three year support package (i.e. the funds held on Royal Mail's balance sheet).

ii. That I should make a written statement to the House, provisionally on 16th September, a draft of which is included at Annex 3, announcing the funding and the policy on closures.

iii. My officials should engage with POL on the detail, signalling in broad terms the Government's plans and timings, putting pressure on POL to drive forward with pilot activity, indicating what sort of alternative forms for service delivery the Government would like to see covered by the pilots and indicating what feedback from the pilots the Government would like and when it will be required.

iv. That we should ask POL to report formally on the pilot activity and its implications for future access to post office services, and provide a progress report assessing the impact of the move to direct payment on POL and sub-postmasters and the implications for rural network viability of new revenue streams, by the end of 2005.

v. DTI, supported by Defra and ODPM and the devolved administrations, will establish a working group to ensure that work on future access to post office services is co-ordinated with wider work that Defra and the devolved administrations have in hand to ensure access for those in rural communities to cash and retail services.

vi. DTI officials will ensure that handling and presentation is co-ordinated effectively across Departments and the devolved administrations.

vii. A full options paper on the long-term future of the rural network, informed by the work streams above, will then be submitted to DA for consideration by the end of March 2006.

I am copying this letter to the Prime Minister, members of DA and Sir Andrew Turnbull. The letter will be sent separately to the devolved administrations.

Best wishes,

PATRICIA HEWITT

ANNEX 1

BACKGROUND ON THE RURAL POST OFFICE NETWORK

1 Introduction

There are over 8,000 post offices serving rural communities – around half of the total network. Around a third of all rural communities has a post office (and most communities with more than 500 inhabitants have one) and 84% of the rural population lives within a mile of a post office. Rural post offices are viewed as an important part of the rural infrastructure, offering local access to benefits, cash, information and a range of postal, government and financial services. They are highly valued and any proposals for change – whether to the services they offer, their ownership or their location – attract a high level of interest and concern.

The rural network in its present form is far from self-sustaining. 90% of rural post offices lose money for POL (rural network losses total £150m a year) and many have too small a customer base to be viable businesses for the sub-postmaster (many survive only because sub-postmasters run them as "lifestyle businesses" rather than as their primary source of income). 10% of rural outlets have fewer than 20 customer visits a week.

Post offices are also in the middle of a major period of change as the way in which benefits and pensions are paid is modernised and fewer people want to collect their benefit in cash at post offices. Post Office Ltd is introducing a wider range of cash, banking and financial services to combat this decline in traditional income, but it is too early to say how successful this will be.

2 Progress since the PIU report

Against a background of uncertainty, the PIU concluded in June 2000 that the network had failed to keep up with changing customer demands and was in a precarious position, and that a combination of Government action to preserve access to the post office network and management action to increase efficiency and maximise its commercial potential was needed to see the business through the very difficult transition to Direct Payment of benefits and pensions from 2003. The Government accepted all of the PIU report recommendations.

Although the network faces considerable challenges and uncertainties, in some respects its future prospects are clearer now than they were in June 2002. A great deal of progress has been made:

- A new management team has developed and begun to implement a commercial plan, cutting out inefficiency, making the business customer-focused and pinpointing the service areas with real commercial potential to be developed.
- Post Office Ltd has reduced its financial and operational dependence on Royal Mail. Whilst it remains part of the group, it is now a self-standing business.

- Automation of post office counters is now complete, with Horizon terminals in use at all outlets.
- The transition to direct payment of benefits and pensions is well under way. New basic banking services and additional commercial banking facilities have been introduced.
- Modernisation of the urban network is well under way.
- A Government funding package has been agreed and cleared by the European Commission. The package has secured the future of the network until 2006 and includes a sum of £450m to maintain the rural network for three years (2003/4 – 2005/6).
- Postcomm has issued its advice to the Government on the long-term future of the rural network.

The funding arrangements put in place in 2003 are designed to support the post office, including the rural network, during the transition to direct payment of benefits and pensions. But it is also now clear that even when the new management team has the business running efficiently with its commercial potential fully exploited, the rural network cannot be maintained in its present form without ongoing financial support from Government. The issue goes deeper than efficiency and new business development. It is structural: there are too many post offices serving very small (and declining) client bases.

The advice submitted by Postcomm provides a considerable amount of information on which to base future Policy options. There are, however, a number of areas where in an ideal world we would like to have greater certainty. It is relatively early on in the move to Direct Payment so we cannot know where that will lead. We have relatively little information on the migration of business from offices closing under urban reinvention to those remaining. And the prospects of the proposed new range of financial services is unknown.

3 Current Government financial support for the post office network

In addition to contributing £480m towards the cost of automation in 1999, the Government has committed some £1.7bn to supporting the post office network. This is made up of a package of measures following the publication of the PIU report, and a further package in 2003.

The post-PIU measures:

- £210m to fund the modernisation of the urban network.
- A £15m fund to provide support for post offices in urban deprived areas
- A £2m fund to assist rural communities with capital start-up costs.
- £25m for pilot activity on the Government General Practitioner project.

Last year the Government delivered a further £1.5bn financial support package for the network comprising of:

- £726m to clear debt accumulated prior to 2003/4.

- £450m to meet the extra costs incurred in maintaining a rural network with 6,600 more outlets than could be sustained commercially. This funding covers the 3-year period from 2003/4 to 2005/6.
- Provision has also been made to fund losses and cash outflows during the period 2003/4 to 2006/7.

The Government has used powers under the Postal Services Act to ensure that the package is funded from reserves accumulated within the Royal Mail. The post office network would not have been able to continue in its present form without this funding. Royal Mail could no longer afford to fund Post Office Ltd's rapidly rising debt and the rural network could not be sustained without substantial payments from Government. This was the situation faced by the post office network before any financial effects arising from the transition from order books to direct payment of benefits and pensions are felt. Without Government support the management of Post Office Ltd would have had to take drastic action to scale down the network to a commercially sustainable size. Most rural post offices would have closed and even then it might not have been possible to save the business from insolvency.

In December 2002 the Government signed a Framework Agreement with Post Office Ltd to ensure that the funds are used only for specifically defined purposes. It has also signed a Memorandum of Understanding (MOU), which sets out in more detail the purposes for which the £450m funding for the rural network is to be applied.

The MOU requires Post Office Ltd to spend the funds to maintain a rural post office network by ensuring that, except for limited and agreed activity to pilot new ways of delivering access to post office services, there are no avoidable closures of post office branches in rural areas. Where closures are not avoidable, Post Office Ltd will follow the provisions of its Code of Practice on closures which are designed to ensure proper consultation with interested parties and that all reasonable alternatives to closure are fully explored.

The funding is allocated for three specific purposes:

- £198m to maintain Assigned Office Payments (the fixed element of remuneration) to sub-postmasters of branches serving rural communities at a minimum level equivalent to the rates used in 2002/3.
- £227m to meet the variable costs required to support the network. (No payment is being made in respect of Post Office Ltd's fixed central overhead costs).
- £25m for a flexible fund to meet the cost of pilot activity to promote innovative ways of delivering post office services in rural areas.

In addition to the support package being funded from accumulated reserves , a secured loan facility for up to £1.15bn is to be made available until 2010 to fund Post Office Ltd's working capital requirements (primarily cash held in the network). This requirement has, until recently, been funded largely by DWP.

ANNEX 2

EXTRACT FROM POSTCOMM'S ADVICE ON THE FUTURE OF THE RURAL POST OFFICE NETWORK

SUMMARY

1. The Performance and Innovation Unit's June 2000 report on the Post Office network recommended that Postcomm "should work with key stakeholders … to develop a shared understanding of the role that post offices should play in the longer term and advise the Government on the main options for the policy framework after 2006". The scope of the advice required by Government was set out in a letter from DTI on 29 November 2002, stipulating that the advice should cover the rural network alone and be delivered by 31 July 2003. This report is Postcomm's response.

2. No-one disputes that the rural Post Office network faces major challenges. Postcomm's research over the past three years has confirmed a continuing gradual decline in customer numbers, resulting from social, economic and technological change. People are finding other ways of accessing services that they used to find at a Post Office branch. There is only limited demand for new products and services to meet unmet needs.

3. But there are pressures in the other direction to keep rural Post Offices open. Access to cash will remain a key need for disadvantaged groups, particularly those on low incomes or without a car. Even though the practical importance of Post Office branches as a source of services will diminish, people will continue to value a Post Office branch as a focal point in rural communities. This means that the prospect of public protest at any re-modelling of the network is more likely to increase than decrease over time.

4. Postcomm believes that the implication of these contrasting trends is that the current problem of the general population liking to have a local Post Office branch, but hardly using it, will get worse in many communities. Post Office Ltd's current losses from the rural network are therefore likely to increase over time, making it even harder to provide services for those vulnerable people who rely on them.

5. In order to analyse the benefits to communities of having a local Post Office branch, and find out how 'liking to have' a local branch translates into what people would be prepared to pay to keep the local branch service, NERA has carried out a cost benefit analysis of rural Post Office branches. Its findings are stark:

> Costs v. revenue Almost all rural Post Office branches already cost Post Office Ltd more to run (support costs plus subpostmaster salary) than the revenue they bring in. The smallest branches make the largest loss in proportion to income generated, have the fewest customers and the highest closure rate. The relatively few profitable branches, around 10% of branches, all in the larger rural size groups, produce an average profit of 1p per customer visit for Post Office Ltd. And no-one could contend that subpostmasters are well paid.

Benefits v. costs If, for the smallest 20% of branches, the household benefits (the value placed by local people on the local branch's availability) are added to Post Office Ltd revenue related to those branches, this benefits total is still less than the cost of those branches to Post Office Ltd. In contrast, the total benefits of the other 80% of branches are greater than their costs to Post Office Ltd, even though most of these branches are loss-making for Post Office Ltd.

Closures

6. Our research has found that, despite the extensive public and media dismay that tends to surround closure of a local rural Post Office, all but a few people adapt readily to such closures. It is the few who then find it very difficult to access services provided by Post Office branches, particularly to cash their benefits or pension payments, who need alternative provision if their local branch closes.

What is to be done?

7. Given the tension between the twin facts that most of the rural network makes losses for Post Office Ltd, while benefits outrank costs for all but the smallest branches, there is a clear need for the Government to decide what it wants from the rural network, and to fund the services it wants the network to provide. It cannot expect Post Office Ltd, as a commercial company, to fund continuing losses on a network far larger than the company needs.

Small branches

8. NERA's findings on the costs and benefits of the smallest 20% or 1600 rural branches indicate that they have high costs per customer, as well as costs higher than benefits. Over 800 of these branches average fewer than 20 customers a week, yet on average cost Post Office Ltd 17 times more to support than the revenue it receives. The smallest 20% of branches are also the most likely to close; 50-60% of rural closures over the past three years have been of branches with fewer than 70 customers a week, and 25-30% of closed branches had no attached business and fewer than 70 customers a week.

9. Numbers of branches are too great for the sustainability of the rural network, indicating a need for managed reduction. To help start this process, the Government should end the requirement it has placed on Post Office Ltd to 'prevent avoidable closures' in the rural network and instead agree to Post Office Ltd planning the network systematically on the basis of Government guidance, enabling service provision to be better adapted to local customer needs. Guidance could take the form of access criteria based for example on population, or on walking distance or time taken to reach a Post Office branch. Where customer numbers are insufficient to support a local branch, but disadvantaged groups need to access Post Office services, local solutions will need to be found. Alternative service provision could take the form of a satellite branch open for a few hours a week, or home delivery by postman, subpostmaster or other agent, or provision of transport to a Post Office branch in a neighbouring town. The precise form of alternative provision will depend on the

location needing the service, and on the results of trials being carried out by Post Office Ltd.

10. This does not mean that all small Post Offices should close. Helping to meet the cost of running a rural Post Office branch are four possible kinds of input:

- the Post Office branch itself generates income for Post Office Ltd (revenue in the form of payments from clients such as DVLA, Royal Mail, utility companies etc, for services carried out for them)
- the branch often benefits from co-existence with a shop or other business or service on the same premises
- the local community may put time and effort into the Post Office and any complementary business, through voluntary help and fundraising activity (as well as buying goods and services there)
- the Post Office branch has a social and economic value locally, which might be recognised via financial support from Government.

11. Postcomm's research shows that there is typically a large gap between the cost of running the smallest Post Office branches and the revenue which accrues to Post Office Ltd. Therefore, unless there is also a profitable shop or other business attached, and/or significant support from the local community, it is unlikely to make sense for Government to offer to close the proportionately large cost gap. But where one or more of these other elements exist, the economic and social value of the Post Office branch is likely to be worth preserving.

Larger branches

12. Larger rural Post Office branches generate levels of income for Post Office Ltd much closer to the cost of running them. If these branches are also supported by a strong "private side" much used by the local community, then Government funding may not always be necessary. In most cases it would appear sensible to offer financial support from central government to close the narrow financial gap needing to be bridged to keep these branches open.

13. To help improve their overall business viability, it is important that Post Office Ltd allows subpostmasters to take advantage of new business opportunities as they arise from whatever source, local or national, including other postal service operators.

Funding

14. Because all but the largest branches lose money for Post Office Ltd, Government will have to continue to provide funding for the rural network if it wants to avoid social upheaval through loss of Post Office services in rural areas. Funding additional to Post Office Ltd's contribution will be needed even if Government ends the 'prevent avoidable closures' requirement on Post Office Ltd, and agrees to a planned network with alternative service provision. Postcomm believes that Government should be prepared to pay for the cost of fulfilling its own social agenda, by enabling the socially excluded to access cash, and by supporting the economies of rural communities.

15. Government must decide on its primary reason for providing this funding and use this reason as the basis for its decisions on the extent of the physical Post Office network, on possible access criteria and on funding levels. This funding could be used to:

- stimulate more entrepreneurial behaviour among subpostmasters so that their businesses react to local demand and complement other rural service providers, in line with the Rural White Paper agenda
- allow for alternative, more flexible, forms of Post Office service provision, once these have been trialled by Post Office Ltd, to complement provision of branch services
- encourage Post Office Ltd to find ways to make further cuts in its costs of supporting the rural network
- change the way subpostmasters are paid, so that the funding does not reward those on fixed salaries while risking insufficient support being given to those paid mainly on a per transaction basis.

POSTCOMM'S RECOMMENDATIONS

Against the background that:

1. Post Office Ltd currently makes a loss on all but the busiest rural Post Office branches, generally with over 2,300 customers a week

2. the benefit to households of having a local Post Office branch exceeds Post Office Ltd revenue for all sizes of rural branch; the difference is proportionately greater for the smaller branch sizes

3. the benefits (household benefits plus revenue to Post Office Ltd) of about 80% of Post Office branches are greater than the cost to Post Office Ltd of running them

4. the reverse is true for the smallest 20%; maintaining many of the 1,600 smallest Post Office branches is not justified in terms of costs incurred by Post Office Ltd compared with their total benefits

5. usage of rural Post Office branches will fall by 2011 as Post Office Ltd's clients increasingly take advantage of cost savings offered by new technology to provide services in other ways

6. the symbolic importance of the Post Office branch as a focal point in rural communities and the prospect of public protest at any re-modelling of the network will increase by 2011, even though branches' practical importance as a source of services will diminish for most people

7. actual demand for current Post Office services and products will fall, so that by 2011 the cumulative reduction will be an estimated 12.5%, even with the new banking services. Demand for new products and services to meet unmet needs (e.g. collection of undelivered parcels) is limited. Post Office Ltd's current losses on the rural network are therefore likely to increase over time

8. the importance of Post Office branches in terms of practical need and levels of use will reduce by 2011 for both the general population and for many vulnerable people, as they change the way they access services

9. Post Offices branches in 2011 will remain important for some people in disadvantaged groups – particularly those on low incomes or without a car - but be less important than at present for those over 65 or carers

10. Post Office branches by 2011 will become outlets providing postal and basic banking services including accessing cash - access to cash will remain a key need for disadvantaged groups

11. the current problem of the general population liking to have a local Post Office branch, but hardly using it, will get worse in many communities, making it

even more difficult for a sustainable service to be provided for those vulnerable people who rely on it

12. although new products and services can help to reduce the financial losses incurred in running the rural network, foreign experience indicates that only structural changes to the network will provide for a reduction in losses in the medium term

13. most people, including most people who are elderly, disabled or on low incomes, adapt when a rural Post Office branch closes and use a branch in the town where they do their shopping

14. a minority of disadvantaged people find it difficult to adapt when a Post Office closes

15. provided alternative provision is made to ensure that Post Office services are available to people who cannot cope when their local Post Office closes, further closures of smaller little-used Post Office branches can be justified, though public protest will be loud

Postcomm makes the following recommendations:

Need for clarity of objectives

1. Government should continue to provide some form of funding for the rural Post Office network after 2006, but it should recognise that the role of the network is changing – it must move beyond the strategy set out by the PIU in 2000

2. Government should be clear about its primary reason for wanting to have a rural network of physical Post Office branches

3. the primary reason for Government providing financial assistance to maintain physical Post Office branches should be economic: to support village shops and the economies of rural communities, and to provide access to cash

4. separately, to meet the Government's objectives under its social inclusion agenda, the Government needs to ensure that essential services are accessible to vulnerable members of society, by using an 'exceptions' or other alternative means of service provision, as necessary

Size and shape of the network

5. the "prevent avoidable closures" requirement should not be renewed in 2006.. Government should now start to advance from its simple "no avoidable closures" policy to a more complex message of maintaining access to Post Office services in rural areas in a practical way, matching the way in which people live their lives and cope with change

6. ending the "prevent avoidable closures" requirement would need to be counter-balanced by a clear package of measures indicating how accessibility of key services will be maintained, especially for vulnerable groups. Such a package can only be put together after Post Office Ltd's trials of different types of alternative service provision have taken place and the Government has decided what it wants the rural network for

7. Government should agree to Post Office Ltd using its NetSpec modelling tool to plan the rural network in relation to population and small business distribution, so as to ensure reasonable access to cash and help village shops and other small businesses and service providers to survive

8. Government should specify access criteria as guidance for Post Office Ltd to plan the network. Access criteria should give high level guidance on minimum acceptable standards of Post Office service provision, rather than detailed instructions. Different criteria should be used for different types of community

9. as part of moving towards a planned network, Government should discuss with Post Office Ltd the need for a programme of rural reinvention in rural towns and how this would be funded

10. any process of planning the rural network should result in the closure of some little used Post Office branches but also the opening of Post Office branches in some communities

11. if some little used Post Office branches are closed as part of a planned programme, the subpostmasters should be able to apply to a fund to seek recompense for any disruption caused

12. no programme allowing wider closure of smaller branches should be undertaken until the trials of alternative delivery mechanisms have taken place and their costs and effectiveness in meeting customer needs have been measured

Funding and encouraging sustainability and innovation

13. for the period beyond 2006, the funding arrangements made for 2003-6 should be replaced by arrangements with clear aims and measurable success targets

13. Government should reduce over time any funding which it provides to meet Post Office Ltd's support costs, to reflect falling customer numbers and to encourage Post Office Ltd to continue to innovate and find further efficiencies to cut the support costs of the rural network

14. Government should look into what further steps it can take to encourage innovation and entrepreneurial behaviour among rural service providers

15. for areas where there is no economic or other justification for maintaining a physical Post Office branch, Government should fund alternative means of providing Post Office services to vulnerable members of society who are unable to adapt to loss of a local Post Office branch. Some of these forms of alternative service, such as home delivery, could (subject to trials just starting) be provided by Post Office Ltd, Royal Mail or by other service providers

16. Government should review the basis on which financial assistance aimed at meeting rural subpostmasters' salary costs to 2006 is calculated

17. where the community itself values a Post Office branch sufficiently to put investment in terms of cash, time or voluntary effort into setting up and running the branch, usually with a shop or other small business, the Government should ensure that such efforts continue to receive funding from a range of sources, to keep open this option for service provision in the network

18. Government should provide challenge/pump priming funding to help support sustainable small businesses such as shops attached to Post Office branches and other small businesses which provide important community services and act as hubs for their community

19. Government should note that:

- although this advice describes ways of achieving a more cost effective and sustainable rural network, at this stage Postcomm is not able to estimate costs for the different options because:
  - the trials of alternative service delivery methods are only just getting under way and so their costs and effectiveness in meeting customer needs have not been measured, and
  - ways of structuring and delivering services via a revitalised rural network will depend on what the Government decides it wants from the network, and the mix of different ways of providing Post Office services that would be required to meet its objectives;
- if only limited funding is available, Government will have to choose between:
  - a more radical approach to planning and restructuring the network than we have suggested (i.e. planned and managed large scale closures and provision of compensation, as in the urban network), or
  - providing limited targeted funding based on a hierarchy of population/customer need and letting natural selection take its course for other branches

ANNEX 3

DRAFT WRITTEN STATEMENT TO THE HOUSE OF COMMONS, 15 SEPTEMBER 2004 AND Q&A

STATEMENT ON GOVERNMENT SUPPORT FOR THE RURAL POST OFFICE NETWORK

The Government remains fully committed to supporting the Post Office's strategy for creating a viable and vibrant post office network that meets changing customer needs, providing reasonable access to services in rural communities.

The Performance and Innovation Unit report on modernising the post office network, published in June 2000, recommended that the Government should support the rural network in the first instance to 2006. It also recommended that the Postal Services Commission, Postcomm, should advise the Government on options for the rural network after 2006. I have received that advice and have considered it very carefully.

My honourable Friend the Minister of State for Energy, E-Commerce and Postal Services announced in the House on 2 December 2002 the Government's decision to make £450 million available to support the rural post office network through from 2003 to 2006.

That three-year package was intended as a transitional measure, designed to help rural post offices through the changes in the network's business between 2003 and 2006. At this point in the transition rural post offices continue to face real challenges and a large part of the rural network continues to be unsustainable commercially. For many post offices the number of customers they serve is simply too small to make the business attractive or sustainable. With the prospect of customer numbers continuing to fall as people access services in different ways it is clear that there are difficult times ahead and that new ways to deliver services more efficiently and effectively are needed.

Postcomm's advice is that the reasons for the Government continuing to support the rural network in the longer term should be reviewed carefully and that the nature of that support might need to change, possibly radically. Postcomm's advice recognises, however, that such changes must be well informed and that further work will be necessary.

How and where people access services is changing and it is not clear that the present network best meets those changing needs. A solution for the longer-term will need to take these changes fully into account. Pilot activity, funded by the Government, to test new ways of ensuring access to post office services in rural areas is underway. The lessons that will emerge from these trials over the next 12-18 months will be crucial in informing longer-term decisions about the future shape of the rural post office network. At this stage it is too early to draw conclusions. The Government has, therefore, concluded that now is not the right time to take decisions about the long-term future of the rural network.

I am pleased to announce that the Government has decided, subject to securing any further necessary state aid clearance from the European Commission, to extend its transitional financial facility for rural post offices for two further years from 2006 until 2008.

The Government will make available up to a maximum of £150 million a year until 2008 to enable Post Office Ltd to continue to meet the cost of maintaining the non-commercial part of the rural post office network and to pilot new ways of delivering services. Pilot activity is a key element of the current funding package – we have already allocated £25m to fund pilots. Our intention is that this will continue to be a key element of the package going forward.

The funding will ensure that Post Office Ltd will have money to test new ways of delivering services and will not be forced to close unprofitable rural post offices because of a lack of funding.

Current funding is from the gilts (Government money previously received as "dividends" from the company and made available back to the company for certain specific uses) and it is our intention that the further funding to April 2008 will also come from these gilts. The detailed mechanism, sums of money and timing of payments will be subject to further detailed discussion with the company, as well as being subject to State Aid clearance.

The PIU report recommended that the Post Office should be required to prevent avoidable closures of rural post offices, in the first instance to 2006. Postcomm has recommended that this policy should not be extended beyond then. I believe that we will be better placed to take a decision on the longer-term future of the rural network, including whether the current policy on unavoidable closures should continue beyond April 2006, when we have feedback from the pilot activity now being undertaken by the Post Office.

I propose therefore to ask Post Office Ltd for a full report on pilot activity and its implications for future access to post office services by the end of 2005. I will then review the policy on avoidable closures beyond April 2006 at that point.

Postcomm's main concern about the policy on avoidable closures is that it can lead to post offices being saved or reopened where it is clear that customer numbers have dwindled to levels far below what is sustainable. This needs to be addressed.

I therefore, propose, to amend the definition of what is unavoidable so that it takes into account circumstances where there is no prospect of a viable future for a post office because of a collapse in demand for services in that location. The intention will be to ensure that Post Office Ltd is focussed on maintaining access to services in rural areas fully taking into account local circumstances. This adjustment will not enable the Post Office Ltd to close offices. These changes, yet to be agreed in detail, will be published in due course.

Q AND A BRIEF TO SUPPORT THE SECRETARY OF STATE'S WRITTEN STATEMENT TO THE HOUSE OF COMMONS

1 Policy criticism / delay

Q Why has Govt taken so long to reach a decision? Wasn't an announcement due a year ago?

A The decision to extend funding has been taken in good time – 18 months in advance of the end of the current funding arrangements, and on a timetable agreed with the business, aimed at giving continuity and business certainty to POL and to sub-postmasters.

Q Why has the Government ducked the issue and put off the real decision on the future of the rural network?

A Pilot activity to test new ways of ensuring access to post office services in rural areas is at an early stage. The lessons that will emerge from these trials over the next 12-18 months will be crucial in informing longer-term decisions about the future shape of the rural post office network. At this stage it is too early to draw conclusions. The Government has, therefore, concluded that now is not the right time to take decisions about the long-term future of the rural network.

The Government wants to understand the lessons from the pilot work before it takes long-term decisions. We need to be sure that any new ways of offering access to post office services in rural communities meet the needs of those communities, are cost effective and sustainable. We also need to ensure that solutions are integrated fully with other initiatives to improve access to services for rural residents.

Q Why hasn't the Government acted on Postcomm's advice, which it has had for a year?

A Postcomm has advised the Government on options for the future in line with the PIU recommendation that it should do so. We have considered that advice carefully and taken it fully into account in reaching our conclusions.

The report offers valuable analysis and contains the views of a range of stakeholders consulted by Postcomm. It does not, however, offer any magic solutions to the challenges faced by the rural network. Indeed, it advises a degree of caution in proceeding to ensure that the needs of rural communities, and particularly the more vulnerable members of those communities, continue to be met. The Government's decision to fund pilot work, and to review the outcomes before proceeding is entirely consistent with Postcomm's advice.

Q Will Postcomm's advice be published?

A Postcomm's advice to the Government was submitted in confidence. It contains information that is commercially sensitive, not just in relation to POL but in

terms of the thousands of individual businessmen and women who own and run sub-post offices. It is, however, the intention that Postcomm should publish a summary of their advice shortly.

Q Isn't the viability of rural post offices a problem of the Government's own making – scrapping pension and benefit books?

A No. Rural post offices have faced difficulties and been in decline for 25 years. The roots of the problems lie in insufficient demand, particularly at post offices serving the smallest communities. We have benefited from changing social trends such as increased mobility, increased consumer choice and increased independence, aided by technology such as the Internet. These changes are resulting in further decline in demand for traditional post office services. More people are paying bills on line rather than at the post office for example. Post office networks across the world are all facing similar challenges.

2 Funding

Q Where is the money coming from?

A The Government owns reserves held in the form of secure investments within Royal Mail Group. In 2003 it directed Royal Mail, using powers under the Postal Services Act, to transfer the funds to support the rural post office network from 2003 to 2006 into a reserve within POL established specifically for the support of the rural network. The intention is to issue new directions in due course for funding between 2006 and 2008.

Q Why do we need clearance from Brussels?

A As with the existing support for the rural network, there is a possibility that the European Commission will take the view that this support constitutes a state aid. We believe that we will be able to satisfy the European Commission, as the nature of the support proposed is similar to what is already in place. The Government will need to follow established notification procedures to establish whether the proposed extension is a state aid. If the support is deemed to constitute aid, we will need to demonstrate to the European Commission that the aid is allowable under the state aid rules in order to get clearance.

Q What happens if we don't get state aid clearance?

A This is most unlikely. We were able to satisfy the European Commission last time round and the nature of the support has not changed.

Q What will the money be spent on?

A The funding will be provided to meet the following costs:

1. The fixed element of sub-postmaster income (known as the Assigned Office Payment (AOP)
2. The cost to POL of supporting the rural network (computer systems, secure deliveries of cash, training, helpline support etc)
3. A fund to meet the cost of pilot activity

3 Post office closures

Q Why are rural post offices still closing every year?

A The rural network has been contracting for many years. Government support for the rural network has seen a reduction in the rate of rural closures, but neither the Post office nor the Government can guarantee the future of individual post offices. Unfortunately in some cases closure is unavoidable – for example where a subpostmaster retires and no one can be found to take on the service.

Q Does this announcement guarantee the future of the network at least until 2008?

A The further finding is intended to help the company to sustain the rural network while further work is undertaken on alternative, innovative ways of providing access to postal services in a more effective, efficient, and ultimately viable way for the longer term.

Our policy on unavoidable closures will continue, in the first instance to April 2006, as recommended by the PIU. I propose to ask Post Office Ltd for a full report on pilot activity and its implications fore the future access to post office services by the end on 2005. We will review the policy on unavoidable closures beyond April 2006 at that point.

4 Sub postmasters

Q Why is the Government giving all this money to POL? What about sub-postmasters?

A Sub Postmasters benefit directly and indirectly from this support. Without it, POL would not be able to afford to continue to make the fixed payments on which they depend, and would not be able to supply them with the backup and support that they require. In short, without this support, many rural post offices would simply have to close.

Q If there is too little demand to sustain rural post offices, why doesn't the Government offer the same compensation terms for closure that it does for post offices in towns?

A The Government's urban modernisation programme is based on a clear understanding of the size and shape of urban network that is required. The situation with the rural network is different. The Government is currently funding pilot activity into new ways of maintaining access to services for people living in rural

communities in a sustainable way. No decisions will be taken on the longer-term shape and size of the rural network, and hence the need for closures, until the outcomes from the pilot work are clear.

5 Pilot activity

[We are working with POL on Q&A material to cover the following questions]

Q What pilot activity is under way and where?

Q How is it being evaluated?

Q When will the outcomes be known?

6 Next steps

Q What is the Government going to do while it waits for the outcome of the pilots?

A We will be monitoring progress on pilot work carefully. In addition, DTI and DEFRA Secretaries of State have agreed that it is important for decisions on the future of the rural post office network to be taken in the context of a broader strategy for shops and access to cash in fragile rural economies. DTI and DEFRA will therefore be working closely together to co-ordinate these initiatives and secure input from a range of stakeholders.

From: **Geoffrey Norris**
Date: **7 April 2004**

PRIME MINISTER

cc: **Jonathan Powell**
Ivan Rogers
Matthew Taylor
Pat McFadden
Sally Morgan

ROYAL MAIL: FUTURE OWNERSHIP OPTIONS

We are now well past the half way point in Royal Mail's three year recovery plan and the company is being restored to profitability. The question "what do we do next?" is beginning to be asked.

Alan Leighton in particular is keen to have a forward strategy, in part to motivate the staff. His view is that HMG should agree to a management/employee buy out of the business and he is keen to engage with HMG, over the coming months, to look at the options. His thinking appears to be that a decision should be reached and made public before the election.

The idea of a pre-election announcement alarms Patricia H. She is also reluctant to engage with the company on future ownership options, on the grounds that in the new freedom of information era such discussions would be disclosable. Her preference is to be silent until the election and then to include wording in the manifesto which allows us to bring forward proposals after the election. On the substance she is quite interested in a management/employee buy out.

Shriti, I think reflecting the ChX's view, doesn't want any policy announcement before the election. Like Patricia she favours suitable manifesto wording and then prompt action post-election. She is sceptical of a management/employee buy out. She thinks it would be likely to be poor value for the taxpayer and would probably make Alan and his team very, very wealthy people. She favours a large allocation of shares to employees and a public offering, she would be happy to see a minority government shareholding, at least initially, if this helped make the move more acceptable.

On substance, I am assuming we don't see Royal Mail being permanently in the public sector. Between a buy out and a public offering I would like to go through

the pros and cons and then make a judgement. On timing, the question is do we want to raise the issue of Royal Mail leaving the public sector before the election. And the judgement is how controversial this would be and what is our appetite for controversy on this issue. I am assuming the CWU will oppose. As we would need primary legislation to change ownership in practice we would not be able to actually do anything until after the election. In my mind this points to avoiding any public statement before the manifesto and then moving quickly post election. In the meantime I wonder whether the Byers/Millburn "outriders" shouldn't be encouraged to start talking about the issue?

What do you think?

Probably not want it before the election but definitely after. And it all depends on the CWU. If they were in power, would go for it

GEOFFREY NORRIS

Post office Policy.

GN / JH GM RB CO CM. AB

PRIME MINISTER

UNIVERSAL BANKING UPDATE

Summary

- The move to Direct Payment of pensions and benefits is going well, but more customers than we anticipated are choosing the Post Office card account, with a consequent cost increase to Government.
- We need to improve some aspects of the process for opening card accounts.
- I have decided not to introduce in the coming Session legislation to sanction people refusing to give bank details.

1. It is some months since I last updated you on progress with universal banking and the modernisation of welfare payments.

2. The first thing to record is that, by any standards, the introduction of universal banking has been an outstanding success. Both the Post Office card account, and access to basic bank accounts at post offices, were up and running on 1 April, exactly as planned. There were no teething problems of any significance.

3. Good progress continues to be made. DWP has now written to half the customers it needs to convert from order books and giros – 7.5 million out of 13 million. Of those who have responded so far, nearly 4 million have provided details of existing bank accounts, while 1.8 million have asked for a Post Office card account. Of the rest, many will respond after a reminder.

4. Over 1 million card accounts have now been opened, and some 200,000 of these are already "active", with payments going in and withdrawals being made.

5. A team from the Office of Government Commerce carried out a further "Gateway" review of the universal banking Programme in October. This confirmed the achievement of all involved in having brought the service in on time, without significant teething problems. Overall, however, the OGC team rated the programme at AMBER ("the project should go forward, but with actions on recommendations to be carried out"), because of two issues still to be resolved, which we are already addressing through MISC19.

6. The first issue is customer choice: many more customers than we expected are choosing the card account. In the short term, this may look like good news for the Post Office, but it is not helping them move away from benefit business to more general banking and financial services. And it is not good for the Exchequer, since every card account will cost the taxpayer around £50 a year, eroding some of the savings made from the move to Direct Payment. In particular, 60 per cent of pensioners converting from order books are choosing the card account, even though 90 per cent of pensioners have a bank account already – in many cases, one they already have their occupational pension paid into. Many of these accounts can also be used at the post office. (However, half of all pensioners were already on Direct Payment; it tends to be older pensioners who were on Order Book).

7. It is now clear that many customers have misunderstood the choices on offer, partly because we have gone out of our way to stress post office access. In particular, people have not understood the option of opening a basic bank account and using it at the post office. We have therefore revamped our marketing material to address this issue; we have ensured our own staff are better informed about the options; and Paul Boateng has released funding for us to work with the voluntary sector to give customers a better understanding of the choices. Within DWP, we need to do a great deal better in terms of getting new claims on to Direct Payment from the outset.

8. All this, however, runs the risk of antagonising some stakeholders. Already the NFSP (and the Post Office) have complained about an internal memo to Jobcentre Plus managers which they have obtained. The memo is, in fact, perfectly in line with agreed policy – and is primarily about the need to start new claims on Direct Payment (including into card accounts) rather than creating new order book and giro customers who will need to be converted to Direct Payment within 18 months. However, it is unfortunate that it has stirred the Federation up after they had been very quiet for several months.

9. The second issue is the "journey" customers have to complete to move to Direct Payment. While the vast majority of people we write to respond eventually, and hardly any refuse outright to co-operate, we are starting to build up a non-trivial group of people who have failed to respond, and who will need to be tackled again next year in an exercise known as "secondary conversion". Amongst these are some people who have said they want a card account, but do not seem to complete the process.

10. In particular, customers do not always realise that, having opened a card account, they still need to tell their Paying Department the sort code and account number so we can pay into the account. We (and the Post Office) have already taken a number of steps to address this, and are evaluating more radical action if needed.

11. The OGC team also made recommendations about the governance of the Programme. One concerned the position of the Programme Director. You may remember that Jeremy Heywood's letter of 26 September 2001, setting up the universal banking Programme, made the Programme managers in Inland Revenue, DWP, Northern Ireland and the Post Office answerable to Shirley Trundle for delivering their aspects of the overall Programme. Now that we are 7 months past "go-live", and in view of the good progress so far, I have agreed that Shirley can move on to other duties within DWP. The ub Programme continues however, and will now be lead by Tony Kuczys, who was Shirley's Deputy, and who therefore provides continuity. The OGC team felt it was very important that the relationship with the Departmental programmes should remain as before, and I hope you can agree this.

12. You will be aware that I was planning to introduce a short Bill in the coming Session so that we could insist on paying people directly into their accounts, unless they had genuine difficulties. Similar provisions were made last year in the Tax Credits Bill. In view of the fact that we have seen little sign of people refusing outright to convert, and the potential for such a Bill to prove counter-productive, as well as attracting a coalition of opposition to proposals for sanctions for refusing to provide bank account details, I have decided not to press ahead with it this Session, but to hold it in reserve if it should prove necessary. I have written to DA and LP confirming this position.

13. Finally, I want to look ahead 12 months. By this time next year, we will:

- have written to all 13 million existing order book and giro customers, completing "primary conversion"
- be well into "secondary conversion", going back to customers who have not responded, and any new customers who have not gone straight on to Direct Payment
- have issued the last 20-week order book, to run out in early 2005
- have an Exceptions Service in place for those who cannot be paid into an account

All, I hope, without hitting the headlines or creating "martyrs", and in a way that delivers cash savings for Government. This remains a significant challenge, and there is still a lot to do in the coming months.

14. I am copying this note to Gordon Brown, Paul Boateng and Dawn Primarolo, Patricia Hewitt and Stephen Timms, Douglas Alexander, Sir Andrew Turnbull and Geoffrey Norris.

Andrew.

A. S.

COVERING RESTRICTED

CABINET SECRETARIAT

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DATE ▪ 13 November 2003

OUR REFERENCE ▪

YOUR REFERENCE ▪

David Prout
PPS/Deputy Prime Minister
26 Whitehall
London
SW1A 2WH

MANAGING POST OFFICE CONTRACTS

I attach a paper, prepared here in the Economic and Domestic Affairs Secretariat, about Government contracts with Post Office Limited. This follows a commission from DA Committee for Cabinet Office to set up a mechanism for monitoring such contracts. The aim is to ensure that Ministers can take a collective and co-ordinated view of plans to change or cancel contracts, which might damage the chances of meeting the Government's objectives for the Post Office network.

The paper sets out proposals for the new mechanism, which have been cleared with all the parties involved. DA Ministers are invited to agree the approach. If your Minister or any other member of DA Committee has any comments or objections, I would be grateful to receive them by Friday 28 November. Otherwise, I will assume that the new approach has been agreed and it will become operative from the start of December.

I am copying this to Jeremy Heywood, private secretaries of all DA Ministers and Ian Fletcher in Sir Andrew Turnbull's office. Copies also go to PS/Peter Gershon, David Smith (DWP), Nigel Leese (DTI), Geoffrey Norris (No 10) and Paul Britton and Jaee Samant here.

Lucy Sydney

INVESTOR IN PEOPLE

MANAGING GOVERNMENT CONTRACTS WITH POST OFFICE LIMITED

Summary

1. This paper records a list of Government contracts with Post Office Limited (POL) and sets out proposals for a central mechanism for monitoring such contracts and allowing Ministers to collectively consider proposed changes to contracts, in order to ensure that the Government continues to meet its objectives for the Post Office network.

Issue

2. Last time the Domestic Affairs (DA) Committee discussed the future of the Post Office network, it concluded:

- that the Government reaffirmed its commitment to a viable Post Office network, providing access to cash, postal and Government services;
- that the Government would support the rural network financially, in the first instance to 2006; and
- that the Cabinet Office should set up a mechanism to monitor Government contracts with POL, and any major changes proposed to contracts should be reported to the Committee.

3. This paper is concerned with the last of these conclusions. Co-ordination of Government contracts with POL is required because a decision to cancel or vary significantly a contract has the potential:

- to undermine the Government's commitment to providing access to Government services through post offices;
- to undermine the financial viability of the Post Office network; and
- to increase POL's dependence on financial aid provided by the Government.

4. The aim is not to anticipate the procurement decisions of individual departmental accounting officers, but to ensure that the wider aspects of policy and value for money across Government, in particular the effect on the Government's policy objectives for the Post Office network, are taken into account.

Supporting the network

5. The Government has made a number of commitments around supporting the Post Office network, particularly in rural areas. Most importantly, it has a current contract with POL worth £150m a year to prevent all avoidable closures in rural areas until April 2006. Work on what to do post-2006 is underway and proposals will be submitted to DA within the next few months.

6. POL is heavily dependent on income from Government. Currently Department for Work and Pensions (DWP) business accounts for almost 40% of its income and contracts with other parts of Government for delivery of a wide range of government services (car tax, passport applications, TV and fishing licences, etc) collectively represent significant value. A list of contracts with the Post Office, including their duration and value, is at Annex A. The list also includes details of known possible or planned changes to those contracts (although it should be noted that not all of these changes will definitely happen).

Market changes

E-Government

7. E-government and the move towards greater online service provision is likely to impact heavily on contracts and on the value of those contracts to POL. For example, the DVLA is working up proposals for electronic vehicle licensing. By March 2008, 40% of all re-issued licences are expected to be dealt with electronically, which will have a major impact on the value of that contract (currently £51m per annum (excl. VAT)). Similar changes are expected in a number of other areas, such as passports, driving licences, and asylum seeker and E111 cards. In addition, some changes are planned which will create service efficiencies at Post Offices. For example, DVLA's project on barcoding all re-licensing transactions (BART) will partially automate the clerical process for handling such transactions, hence reducing transaction charges to DVLA.

Postal Services

8. The commission from DA was concerned with the counter services provided by POL, rather than postal services provided by the Royal Mail. It is worth noting, however, that the deregulation of postal services by 2007 is likely to impact on the income of Royal Mail Group as a whole. Expenditure on postal services (currently £225m pa in central Government, the vast majority of which goes to Royal Mail) is in fact expected to rise in coming years as a result of more direct marketing to customers. However as the market opens up, contracts will inevitably be won by Royal Mail's competitors. The Office of Government Commerce is working in consultation with departments, developing a cross-Whitehall approach on Government use of postal services.

Mechanism for monitoring the network and agreeing potential changes to contracts

9. As long as POL continues to be dependent upon Government for a substantial part of its business, and on financial assistance to sustain the uneconomic rural network, it is important that the wider picture of contracts with POL across Government is monitored, and Ministers are able to judge how a change to a contract would impact on POL and how it might effect the level of subsidy required from government to retain services. A decision to go ahead with a change to contract should be subject to the change being consistent with Government commitments and objectives for the Post Office network.

10. It is proposed that the existing official-level cross-departmental Royal Mail User Group (RMUG) act as the primary forum to monitor the situation and assess proposed contract changes. RMUG is chaired by David Smith, Commercial Director of DWP[1]. Its current membership covers the majority of the key contract managers involved with the Post Office and Royal Mail. The Group reports to the Office of Government Commerce Chief Executive's Advisory Group, chaired by Peter Gershon.

11. It is proposed that the RMUG should prepare, on a half-yearly basis, a situation report about Government contracts with POL, for consideration by Peter Gershon's group. Further, any department proposing to cancel or change a contract with POL should write to the chair of RMUG, copied to the Cabinet Secretary, setting out the proposal. RMUG would then prepare a policy report on the proposal. This report would be subject to clearance by Peter Gershon's group. The Department of Trade and Industry Postal Services Directorate should

[1] David Smith, tel 020 7391 1616, address Room 814, Tavis House, 1-6 Tavistock Square, London WC1H 9NB, email David.Smith1@dwp.gsi.gov.uk.

then prepare an assessment of the impact of the proposed change on the company and against the government's objectives for the network. Any major changes proposed to contracts would be submitted to DA Committee for clearance.

12. **This mechanism will allow Ministers to be informed collectively of any significant changes proposed to Government contracts with POL, and to assess the government-wide impact of changes to contracts, taking into account all the relevant policy factors, including procedure rules, value for money and impact on subsidy to the company.**

Devolution

13. Post Office contracts are devolved. It is therefore proposed that the devolved administrations are informed of the proposal to have a centralised mechanism for informing Ministers of changes to Government contracts and invite them to be included in the process.

Ministers are invited to endorse this approach.

Cabinet Office
November 2003

Main Government contracts with the Post Office

Dept	Contact	Contract	Length	Value	Potential Changes	Notes
DWP	Ken Davenport	Order Book		2002/03 £375m	Significant shift from order book to payment direct into bank accounts. PO has developed 3 services which offer banking at PO outlets. Order books will be phased out by the end of May 2005.	Total Government expenditure on contracts with PO very unlikely to reduce before FY 05/06.
		Post Office Card Account		2002/03 £0 2003/04 £100m 2004/05 £132m 2005/06 £157m Total cost of contract 2003-2010 £1.1bn (approx 75% of total contract)		
		Girocheques/ Exceptions Service		circa £28m - £30m		
		Post Office Point of Sale (POPOS) contract to display and distribute leaflets et al		£2m pa	PO has given notice of termination of POPOS contract; details of replacement service not known.	
DSD – Northern Ireland Social Security Agency	Barbara Brady	Encashment of foils	9 year contract due to expire March 2005	(figs for 2001/02) £11.9m	Order books being phased out in favour of direct payment.	
		Issue of milk tokens		£111k		
		Issue of Game Licences and E111's and payment of prescription refunds		£62k		
		Post Office Point of Sale (POPOS) contract to display and distribute leaflets et al on behalf of SSA		£63k (inc VAT)	PO has given notice of termination of POPOS contract; details of replacement service not known.	
		PO Card Account	April 03 – March 2010	NI share £56.9m (5% of contract)		

Inland Revenue	Keith Parr	Encashment of WFTC/DPTC orderbooks	Expires June 03	£7.3m final payment due 04	Child Benefit order books will be phased out by May 2005. Order book encashment figures could be impacted by any significant changes to the predicted take up of POCAs	
		Encashment of Child Benefit orderbooks		2003/04 £45m 2004/05 £ 7m		
		Card Account at PO	April 03 – March 2010	IR share £228m (20% of contract)		
DVLA	Rob Thomas	Vehicle Re-licensing Contract includes issue of tax discs and other related services (including forms).	5 year contract due for extension/ renegotiation in March 2007.	£51m (ex VAT) per annum	Projected reduction in value of contract of £23m pa by 2008/9 (assuming existing contract rolls forward), resulting from 2 main changes: i. Electronic vehicle licensing goes live in 2004: 40% of all relicences expected to be done electronically by March 2008; ii. Barcoding All Re-Licensing Transactions (BART) Project, which will create service efficiencies at POs.	Contract is unit priced to allow for a reduction in services once electronic vehicle licensing goes live in 2004.

DVLA cont.		Photocard Licence Application Checking Service	3 year contract due to expire November 2004, with provision to extend.	£3m (ex VAT) per annum		
		Tax Disc Savings Scheme (enables motorists to buy savings stamps towards payment of their tax disc)	Notice served to terminate April 2004.	£1.5m pa	POL has served notice to terminate this service, claiming it was a loss making transaction. The suggested alternative to termination was a 38% increase to the transaction price (which would cost DVLA £500,000 pa). Negotiations underway to retain service.	
UKPS	Paul Massey	Passport Application check and send service, Hold and Distribute Passport Application Packs.	1996 –Dec 2004)	POL charge £5 for every application. In 2002 they collected £10m	Considering Face to Face Interviews for first time applicants - late 2004 and discussions to be held with POL re: undertaking such interviews. Considering the introduction of passport cards- late 2004 and discussions to be held with POL re: processing applications. Developing an e-route for passport applications – 2004, this might impact on the Check & Send service that is available at over 2,000 Post Office branches.	

Health	Gareth Jones	Distribution of E111 forms	Current contract expires March 2004 (Single contract with 3 elements)	2003/04 £1.8m +VAT (based on issue of 1.8m forms)	Proposal to replace E111 with European Health Insurance card by 2005 being taken forward. E111s will no longer be issued by the Post Office after Dec 2005.	
		Distribution of milk tokens		2003/04 £6m	DH has given notice of termination of contract wef 2004/5. POCL were invited to tender for replacement service but pulled out.	
		Prescription charge refunds service		2003/04 £60k	Responsibility for negotiating refunds from 2204/05 is delegated to the Prescription Pricing Authority. Outcome will depend on value for money and alternative results.	Figure based on 174,000 transactions. Wales and Scotland are part of this contract for their refunds but meet own costs, est £4k (Scotland) and £3k (Wales)
National Savings & Investments	Colin Gamble	Over the counter sales and transactions of NS&I products, distribution of product literature and commission on direct sales resulting from leaflet pick up in post offices.	Current contract expires March 2004	2002-03 £40m 2003-04 (Forecast) £43m	Currently renegotiating to agree two separate contracts. The first will cover over the counter sales and subsequent transactions of our account based products and will be based on a transactional pricing mechanism. The other will cover over the counter sales and lead generation of our bond and certificate products and will be based largely on sales commission.	
Env. Agency	Tim Griffiths	Fishing Rod Licences	Expires 31 March 2006, option to extend on annual basis up to 31 March 2009	Commission from licence sales paid to PO in 2002/2003 - £1.17m		Approx 1m licences sold pa

DEFRA	Helen Gillard	Under the Post Office Act 1969 the Post Office issues game licences on behalf of district and London borough councils.	during the life of the legislation	Approx £280k pa		Power to vary the fees resides with the Treasury. The fees have remained unchanged since 1968.

RESTRICTED - APPOINTMENTS

4. PR
2. FILE

dti

The Rt Hon Patricia Hewitt MP
SECRETARY OF STATE
FOR TRADE AND INDUSTRY

Awarded yet? NK

24 October 2003

Jeremy Heywood Esq
Principal Private Secretary to
the Prime Minister
10 Downing Street
LONDON
SW1A 2AA

RB
c JJH
GV
KB

Dear Jeremy,

Erica Zimmer, my predecessor, wrote to you on 1 August about the recommendation to appoint Barbara Thomas to succeed Graham Corbett as Chair of the Postal Services Commission. I must now tell you that Ms Thomas has had to withdraw her nomination, for purely personal reasons.

We had not yet announced the new appointment and, whilst Ms Thomas's withdrawal is of course regrettable, fortunately there was a strong field of short-listed candidates. The Secretary of State has now had an opportunity to reconsider the other candidates and I have been asked to convey her further recommendation to the Prime Minister that **Nigel Stapleton** be appointed to the post.

Nigel Stapleton is a successful businessman who currently Chairs Uniq (the chilled convenience food business resulting from the sale of Unigate's milk business to Dairy Crest and its logistics business to Wincanton) and until recently when he had to stand aside was briefly Chair of Cordiant. He is also a non-executive director of the London Stock Exchange and Reliance Security as well as a member of the Financial Reporting Review Panel and a board member of the Royal Opera House. His previous career has included Unilever, Reed/Elsevier and Veronis Suhler Stevenson International. He has also held no-executive appointments with Allied Domecq, Sun Life and Marconi.

Department of Trade and Industry

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The Secretary of State hopes that the Prime Minister will endorse this recommendation. It is proposed that this will be an initial appointment of 3 years with a starting date to be negotiated between DTI/Mr Stapleton and the outgoing Chair (whose term officially ends in March 2004 but who has agreed that he will stand aside when his successor is appointed). Terms and conditions for the post will be based on the current package with remuneration slightly rounded up (from c£72.4k to £75k – based on 3/5 of an annual rate of £125k); the post is pensionable. The Secretary of State would like to be able to make the appropriate announcements as soon as possible.

I am copying this letter to the Chancellor's office and to Sir Andrew Turnbull.

Yours,

Matt

MATTHEW HILTON
Principal Private Secretary

10 DOWNING STREET
LONDON SW1A 2AA

12 September 2003

THE PRIME MINISTER

Dear Gerald,

Thank you for your note. My Office has been in touch with David Mills, the Chief Executive of the Post Office, and David says that David Miller, who is Chief Operating Officer, will make himself available to discuss the issue with you at a time and place of your convenience. I understand that Mr Miller will be in touch with you to make the necessary arrangements.

Yours ever,

Tony

The Rt. Hon. Gerald Kaufman MP

From: Geoffrey Norris
Date: 12 September 2003

Copy: Jonathan Powell
Pat McFadden
David Hanson

PRIME MINISTER

You are meeting John McDonnell and other MPs next Monday 15th September to talk about Royal Mail's decision to start moving more mail by road. The decision is part of the company's financial turnaround plan and they believe it would be more cost effective and reliable. For these reasons Royal Mail seem pretty determined to stick to their decision.

Patricia Hewitt has talked to Alan Leighton about this and Alan is determined to press ahead.

You will need to be in listening mode and avoid raising their expectations for change.

GEOFFREY NORRIS

ROYAL MAIL DECISION TO WITHDRAW FROM RAIL

- Decisions about transport operations a matter for the Royal Mail Board.

- The company is at the end of its first year of its 3 year renewal plan. As announced last year, implementation of the plan will require changes to operational procedures in order to increase efficiency; improve the quality of services; and return the company to profitability.

- The Government regret the loss of this business for rail freight but stands by their policy, called for by the management and the unions alike, of allowing Royal Mail the freedom it needs to operate genuinely commercially.

- Overall, even with the decision about rail services, thanks to more efficient journey planning, Royal Mail's new transport network will use around 2,000 fewer road vehicles and reduce carbon dioxide emissions by 30%.

Background

Royal Mail announced its transport review in March 2002 as part of overall renewal plan. The aim of the renewal plan is to increase efficiency, improve the overall quality of services and return the company to profitability. It said at the time that it intended to move more bulk mail by train, but that fewer train services would be needed, and that it would begin discussions with its suppliers in the rail industry.

Despite protracted discussions with EWS, its main supplier, it has not been possible to renegotiate the contract between them. Under the existing contract, Royal Mail can terminate specific services that are failing to meet the required service standards. Other services will be phased out by March 2004.

Mail currently amounts to 0.5% of total rail freight. Royal Mail always intended to make use of rail in its revised transport network, but has reluctantly had to change its plans on price grounds. The company has not ruled out a return to rail in future.

Implementation of Royal Mail's overall transport review will affect some 2,500 jobs across their distribution operation. The withdrawal from rail services does not change that figure. Royal Mail will seek to achieve any job losses through natural wastage and redeployment of staff within other parts of the company, under an agreement reached with the unions.

Facts

Volume of mail carried by rail: 14%; 11 million items per day

Mail as a percentage of total freight: 0.5%

Government target: increase in **rail freight's** share of the freight market to 10% by 2010 (an increase of 80%).

Number of trains currently used: 49

From: Geoffrey Norris
Date: 9 September 2003

PRIME MINISTER

cc: Sally Morgan

POST OFFICE & GERALD KAUFMAN

Attached a rather grumpy letter from Gerald complaining about Patricia. Given Gerald's seniority and the fact that he was the industry minister with responsibility for the post office in the 1970s, Patricia has handled him particularly well. I have got the Post Office's Chief Executive to look at the point concerning Gerald and he has offered to get his Chief Operating Officer to meet him. Have drafted a reply to Gerald on these lines. **OK?**

GEOFFREY NORRIS

cc Jonathan ?
Pat McFadden
Jeremy H

PM

There is a possibility of a settlement before the ballot result + Alan L should make an effort to get one. Any settlement must be as close as possible to the current envelope, but with some tweaking to give the union something. Presentationally, we need to say a strike would be damaging + that the Royal Mail needs to implement change. And that we want management + unions to sit down and reach a settlement.

From: Geoffrey Norris
Date: 5 September 2003

PRIME MINISTER

cc: Jonathan Powell
Jeremy Heywood
Pat McFadden
Sally Morgan
Nita Clarke
David Hill

ROYAL MAIL DISPUTE

We must be v. touch on this; & Sarah Leighton

Where are we?

Chaotic talks last week at ACAS failed to resolve the dispute. CWU is now balloting its member on industrial action and the result should be known on the 18th September. In the event of it being in favour of industrial action this could begin from the 24th September. The action could take a variety of forms. It is likely that the Union would go for a series of 24 hour stoppages. Apart from delay to the postal deliveries, the vulnerability from action would be its impact on the delivering of benefits to claimants. In London, where there is also a ballot of Post Office staff over London weighting, there is a risk to disruption to the cash handling operation and therefore a threat that post offices will not have cash to pay benefits.

Why the dispute?

The dispute is about pay and changes to working practices – moving to a single delivery. Implementing the single delivery is a very significant part of the Royal Mail's financial recovery plan and its implementation has already been delayed by almost a year because of the failure of the company to reach agreement with the union. The offer to employees is a 14% pay increase over eighteen months,

the point of contention is the "strings" attached to getting the extra money. Traditionally money has been paid upfront for productivity changes which often then failed to materialise. This time the extra money is more clearly linked to the delivery of improved performance. The point at dispute is how much is paid up front.

Assessment

Leighton is taking a fairly tough approach. The offer is not a bad one and he thinks the CWU is struggling to get support for its position. From my meeting with Billy Hayes and Dave Ward yesterday I sense that indeed they are not that confident. Leighton's strategy at the beginning of the week has to have no further contact with the union until after the ballot result was know, we have now persuaded him to agree to a further meeting and this will hopefully in the next few days.

In the event of industrial action

DTI is co-ordinating preparations for dealing with industrial action. As the politically most sensitive impact would be in the DWP area it might be sensible, and make sure he is personally focussed on the issue, for us to ask Andrew Smith to report on his department's contingency plans.

GEOFFREY NORRIS

From: Geoffrey Norris
Date: 29 August 2003

PRIME MINISTER

cc: Jonathan Powell
Jeremy Heywood
Sally Morgan
Pat MacFadden

ROYAL MAIL: INDUSTRIAL ACTION

After fruitless discussions at ACAS, at which the CWU didn't field any of its top officials, the union is now balloting its members on industrial action. We will probably get the result on the 11th September and industrial action could start on the 18th September. The dispute is about how much extra pay postal workers should get in return for significant changes in their working practices, and in particular what are the strings attached to the extra money. Management want the changes first and then extra pay, while the union wants more money upfront.

DTI is currently taking a fairly "hands off" approach to the matter. There are good arguments for this, but I suspect we need to be more active, at least behind the scenes, in trying to get this resolved. **What do you think?**

Yes. We need to see what we can do.

GEOFFREY NORRIS

From: The Rt. Hon. Gerald Kaufman, M.P.

HOUSE OF COMMONS
LONDON SW1A 0AA

12 August 2003

PRIME MINISTER'S
DIRECT COMMUNICATIONS UNIT

14 AUG 2003

RECEIVED

Rt Hon Tony Blair MP
Prime Minister
10 Downing Street
London
SW1A 2AA

Dear Prime Minister

I wrote to the Secretary of State for Trade and Industry, as attached, on 14 July, and have now received the attached totally useless rubbish from her. You will see that she says, "I understand from the Post Office that they have provided the best possible solution for the siting of the local office which will ensure that they are able to offer a sustainable service for local people for the future." This is simply a lie. The Post Office may be trying to convince Hewitt that this is the best solution, but it is one totally unacceptable to my constituents.

It is this kind of aloof, useless response which explains why previously loyal backbenchers such as myself are becoming increasingly alienated from the Government. If Ministers after six years are becoming so remote and arrogant, can you wonder why we are falling behind in the opinion polls?

Yours sincerely

Gerald Kaufman

14 July 2003

Patricia Hewitt MP
Secretary of State
Depart. of Trade & Industry
1 Victoria Street
London
SW1H 0ET

Dear Patricia

I have been trying for nearly 3 years to obtain a replacement Post Office for my constituents in the Rusholme ward of my constituency. I have been involved in correspondence over these years with the Area Development Manager of the Post Office, one John Jones, and a whole series of Ministers in different Government Departments. What we have now ended up with is an alleged replacement Post Office which is nowhere near the location of the previous one. Frankly, I am fed up with this. The area concerned is one where we had a disastrous defeat at the hands of the Liberal Democrats at the May elections this year. The absence of a Post Office played its part in this defeat.

In the previous Labour Government I was in charge of the Post Office. If a Parliamentary colleague had needed a new Post Office I would have instructed my officials to find a way of providing it and the finance required as well. If I could do it, you can do it and I now write to ask you to do it. For your information I attach the totally useless letters I have received from the Area Development Manager.

Yours sincerely

dti

29 July 2003

The Rt Hon Patricia Hewitt MP
SECRETARY OF STATE
FOR TRADE AND INDUSTRY

The Rt Hon Gerald Kaufman MP
House of Commons
London
SW1A 0AA

Dear Gerald,

Thank you for your letter of 14 July about a replacement post office in the Rusholme ward of your constituency.

It is important that all communities have good access to postal and Government services and we are committed to doing all we can to ensure a viable post office network for the future. By accepting all the recommendations of the PIU report, this Government made a concrete commitment to the future of the network and is committed to delivery. As you know we are investing very substantial sums in supporting this transformation of the network – some £2 billion in total over the next 5 years, including £450m funding to support the rural network until 2006. With Government support, the network will continue to play its vital social role particularly in rural and deprived urban communities and effect the PIU vision of a modern network with new business opportunities.

As you know, Royal Mail is now a public limited company wholly owned by the Government. Our reform of the Post Office, implemented in March 2001, gave Royal Mail Group the greater commercial freedom that the management and the unions had long wanted. It established an arm's length relationship so that the Board can run the company as it sees fit on a commercial basis.

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Operational decisions are a matter for the management of the company, including decisions relating to individual post office outlets. In this case, I understand from the Post Office that they have provided the best possible solution for the siting of the local office which will ensure that they are able to offer a sustainable service for local people for the future.

Best wishes,

PATRICIA HEWITT

Post office: Policy file
Copy in DCO Inbox

cc GN
JJH

10 DOWNING STREET
LONDON SW1A 2AA

From the Policy Adviser

5 August 2003

Dear Erica,

POSTCOMM

Thank you for your letter to Jeremy Heywood, dated 1 August, setting out your Secretary of State's recommendation that Barbara Thomas be appointed to succeed Graham Corbett as Chair of the Postal Services Commission.

The Prime Minister is content to follow your Secretary of State's advice.

I am copying this letter to the private secretary to the Chancellor and to Sir Andrew Turnbull's office.

Yours ever,

OLIVER JONES

Erica Zimmer,
Principal Private Secretary to the Secretary of State for Trade and Industry

OM

THE NATIONAL ARCHIVES

DEPARTMENT/SERIES PREM 49 PIECE/ITEM 4287/1 (one piece/item number)	Date and sign
Extract details: LETTER DATED 1 AUGUST 2003	
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Instructions for completion of Dummy Card

Use black or blue pen to complete form.

Use the card for one piece or for each extract removed from a different place within a piece.

Enter the department and series,
eg. HO 405, J 82.

Enter the piece and item references, .
eg. 28, 1079, 84/1, 107/3

Enter extract details if it is an extract rather than a whole piece.
This should be an indication of what the extract is,
eg. Folio 28, Indictment 840079, E107, Letter dated 22/11/1995.
Do not enter details of why the extract is sensitive.

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Sign and date next to the reason why the record is not available to the public ie. Closed under FOI exemption; Retained under section 3(4) of the Public Records Act 1958; Temporarily retained; Missing at transfer
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Minister without Portfolio

CABINET OFFICE

70 Whitehall ▪ London SW1A 2AS
TELEPHONE: 020 7276 1091 ▪ FAX: 020 7276 1088 EMAIL: psianmccartney@cabinet-office.x.gsi.gov.uk

22 July 2003

Graham Meiklejohn
Media and Public Affairs Manager
EWS
310 Goswell Road
London EC1V 7LW

Dear Graham,

Thank you for your letter of 12 June 2003 concerning Royal Mail's decision to transfer freight from rail to the roads.

I understand your concerns on this issue. As you will be aware, in response to a question from John McDonnell MP last week the Prime Minister agreed to meet up with a cross-party delegation of MPs including representatives of your workforce. I suggest you liaise with them to ensure the delegation is up-to-speed with all your concerns.

In the meantime, I have forwarded your letter to the Prime Minister and the Secretary of State for Trade and Industry.

Yours

RT HON IAN McCARTNEY MP

310 Goswell Road
London
EC1V 7LW

Tel : 020 7713 2486
Fax : 020 7713 2311

Ian McCartney MP
House of Commons
London
SW1A 0AA

17/6

(1) Ask PO for a brief - email sent 17/6
(2) Check with DoT number are they supporting EWS
(3) Check what are DTI Ministers claim about it?

12 June 2003

Dear Mr McCartney,

Royal Mail abandons rail services

You will be aware that Royal Mail has announced its decision to withdraw its entire rail network of services for mail distribution by March 2004.

If Royal Mail does abandon rail, they will lose a vital part of their transport network, which achieves high levels of punctuality and reliability. Every rail service must arrive within a ten-minute window at every calling point on its journey. Services have operated at 93.5% punctuality over the last 17 months and 99.9% of all trains ordered have operated.

Royal Mail has stated that it has been unable to progress negotiations after two years. To the contrary, EWS has reduced the cost of train services during the existing contract and has proposed numerous train plans at competitive prices for a future distribution network.

The proposal by Royal Mail threatens 500 jobs within EWS, although none of these jobs are in your consistency.

VAT heavily influences cost comparisons between road and rail for Royal Mail. Royal Mail is unable to reclaim VAT as a state-owned entity, while it incurs no VAT on internally provided road services. The resultant 17.5% cost differential is a principal price issue for Royal Mail.

The proposed move by Royal Mail would increase road congestion, damage the atmosphere and threaten the service quality of mail deliveries across Britain. I urge you to bring these issues to the attention of the Secretary of State for Transport, the Secretary of State for Trade and Industry and the Chancellor of the Exchequer.

The removal of these trains is not in the national interest. I would welcome the opportunity to meet with you to provide a full briefing on this issue.

Yours sincerely,

Graham Meiklejohn
Media and Public Affairs Manager

graham.meiklejohn@ews-railway.co.uk
www.ews-railway.co.uk

English Welsh & Scottish Railway Ltd

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310 Goswell Road London EC1V 7LW
Registered in England and Wales
Registered No. 2938988

DWP Department for Work and Pensions

Our address ub programme
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The Adelphi
1-11 John Adam Street
London WC2N 6HT

Our phone number 020 7962 8505
Our fax number 020 7962 8394
My extension number
Email

Website www.dwp.gov.uk
Date 26th June 2003

c. 03

Geoffrey Norris
No. 10 Policy Unit
10 Downing Street
LONDON SW1

Dear Geoffrey

When they last reviewed the universal banking programme, the Office of Government Commerce recommended that we should produce a "lessons learned" report as a source of information and advice for future cross-cutting programmes. Given that we managed to progress from "red" risk status in early 2002 to successful delivery in April 2003, it is evident that between us we managed to get a lot of important things right. But, looking back, I am sure that there are other things that we might have done better.

The number and variety of participants and interested parties has been a defining characteristic and key challenge of universal banking. I therefore believe it is critical for us to get views from across the programme – your perspective on things may not be the same as ours!

I would therefore be grateful if you would spare a little of your time to be interviewed and to give us your thoughts on what has made the universal banking programme successful (and what could perhaps have been done differently). You will be interviewed by either Andrew Heley of PA or David Sayer of IBM – both Partners with our main consultancy suppliers and both very knowledgeable about the programme. It would be ideal if one of them could see you face to face for up to an hour - but a shorter chat over the phone would be fine if that is easier for you. We aim to complete the interviews during July and to draft the report during August.

Unless you have any objections, you will be contacted within the next few days to schedule your interview. A brief is attached to give you some context for the interview and to help you do some thinking in advance. If you have any concerns or questions, please don't hesitate to contact me.

Yours ever

Shirley

SHIRLEY TRUNDLE

BRIEF FOR UNIVERSAL BANKING "LESSONS LEARNED" INTERVIEWS

The universal banking programme is in many respects unique – not least because of the sheer number and variety of participants and interested parties! However, cross-cutting programmes of this type are likely to become more common within Government and it will be increasingly vital to understand how to make them successful.

The programme has navigated a long journey from the set-up of the individual development programmes in DWP/NISSA, IR and POL and the initial negotiations with the banks, through to go-live of the ub services on schedule in April 2003. Along the way key milestones included the creation of the over-arching programme in September 2001, the signing of the bank contracts in the summer of 2002, the start of customer conversion in October 2002 and the piloting of the card account service from December 2002.

To put the achievement of the journey into perspective, it's worth remembering that the first OGC review in February 2002 rated the programme "Red" in terms of delivery risk. Our aim in developing a "lessons learned" report is to tell the story of the journey and to highlight the key factors which helped make it a success ***as a cross-cutting programme.*** On this basis, we would ask you to think about:

- What do you believe were the particular challenges of this programme?
- What events/occurrences do you believe were of particular significance in shaping the journey and the outcomes?
- What things (i.e. particular actions taken, mechanisms put in place, approaches adopted, attitudes manifested) do you believe contributed particularly strongly to overall success?
- What things do you believe should have been done differently and why? What would have been a better approach?

In thinking about these things, we would ask you to focus on the wider programme, rather than issues affecting mainly your own area- although if you think that the universal banking programme helped or hindered you in achieving your wider objectives we need to know about that. As a "starter for ten" some key themes might include:

- managing inter-programme relationships;
- managing external stakeholder relationships;
- taking the customers' view;
- working collaboratively and ensuring consistency;
- sharing goals;
- managing cross-programme risks;
- ensuring visibility of progress and issues;
- getting key decisions made.

But please don't let this list constrain you – there may well be other things you believe were critical and we want to know your views!

) cc Stephen
Jeremy H (No 10) } Personal – pl don't reveal you've seen this.

The Cion proposal will issue on 29 April. The lines to take (at FT, last annex), whilst mentioning the veto, are relatively moderate – PMG + some SPADs had wanted to be much tougher. The lead option (page 4) looks to me like a reasonable balance between tax + postal markets liberalisation objectives. Chx still considering the position. Customs / HMT will write round when he's opined.

From: Anna Silvester
Date: 26 March 2003
Extn: 5056
Room: 2/N1

CHANCELLOR
PAYMASTER GENERAL

cc: See end

VAT and postal services

Issue:

- Negotiating strategy for EC proposals, in light of risks of (domestic) legal challenge.
- Line to take.

key parts of submission are pl-7 + p21.

Recommendation: That we oppose any Commission proposal to put VAT on stamps, but argue that the postal services exemption should be narrowed to pre-empt legal challenge and support the competition and liberalisation agenda.

① Richard 11/iv

② Back to RC

Timing: Urgent. Commission proposals could be published at any time and Treasury will then be pressed for comment.

Previous papers:
Jackson to PMG 14 February 2002
Jackson to PMG 18 July 2002
Jackson to PMG and EST 16 October 2002

Background

1. The Government has said that it is opposed to having VAT on stamps. Ministers' specific remarks on the subject are at Annex A.

2. At present, Royal Mail's services are exempt from VAT; their competitors' are standard-rated. Some UK postal services providers competing with Royal Mail have an opinion from Leading Counsel that the differential VAT treatment for Royal

Tony Hayward

This looks quite sensible. We should, at this stage, avoid giving anything away. Think a JS+10m

Mail breaches the principle of fiscal neutrality, and is therefore not permissible in EU law. They are threatening to challenge our present application of the VAT exemption (in the UK courts, or in the form of a complaint to the Commission).

3. Our legal advice is that we are unlikely to defend successfully our application of VAT exemption to any non-universal service provided by Royal Mail (for example its Parcelforce business parcels service). Royal Mail's competitors have not yet taken action – we strongly suspect they are waiting for our reaction to the forthcoming Commission proposals (although there is no guarantee they will wait for an outcome before taking legal action).

4. In addition, in a Danish case, the ECJ is considering whether the VAT exemption should be applied to services other than those provided by a monopoly provider under the terms of its universal service obligation. The Advocate General's opinion is expected on 27 March, and its outcome may impact upon the extent to which we can continue to apply exemption to Royal Mail's services. We will be looking at the opinion when it issues, and will provide further advice if it causes us to modify our thinking.

5. Commission proposals to abolish the VAT exemption for postal services and make all postal services taxable – in principle at the standard rate, but with an option to apply a reduced rate for "basic postal service" items up to 2kg – went through Inter Service Consultation in February. We have heard that the Commission expects to publish the proposal either at the end of March or in mid-April. We (and DTI) expect to be pressed for comment by domestic media as soon as proposals are published. We disagree with the Commission's proposal because it would make stamps subject to VAT, but how to negotiate on the proposal in detail is not entirely straightforward.

Options for responding to the Commission's proposals

6. If the only consideration was the Commission proposal (which requires unanimity), there would be a strong case for simply rejecting it, notwithstanding that the Commission and others would take pleasure in alleging an inconsistency with our

position on the liberalisation and competition agenda for postal services (excerpts from two of the Chancellor's recent speeches referring to this are at Annex B).

7. However, even if we saw off the challenge to our current policy posed by the Commission proposal by simple exercise of our veto, that policy would remain highly vulnerable to successful domestic legal action. Under current EC legislation, exemption can only be applied to "public postal services", and legal advice implies that we could not defensibly extend the exemption to Royal Mail's competitors (unless they were to provide a universal service). So if we veto the proposal we will nonetheless remain exposed, not only to criticism of lack of practical action on liberalisation, but also to being forced to change our application of the VAT exemption by the courts in a way over which we could have less influence.

8. We therefore recommend that a robust counter-proposal would be a better opening strategy than simply rejecting the proposal. The objective would be: to ensure that VAT is not imposed on stamps, but in such a way that we can be strongly confident that it will withstand legal challenge – whether in domestic courts or the ECJ. We believe this entails opposing vigorously the Commission proposal, and seeking instead a Directive which provides a firm ground for us and others to exercise a right to exempt those services where we believe there is a strong social case that they should not be subject to VAT.

9. Other than the status quo, there appear to be 3 options that would achieve this:

   a. **A blanket exemption or zero-rate for all postal services from all providers.** This would prevent any VAT-driven increases in the price of stamps (or any other Royal Mail services), and remove competitive distortions by taking VAT off other providers' services. At an estimated cost to VAT revenues of around £500m for a zero-rate (providers charge no output VAT but recover input VAT) or £190m for exemption (don't charge VAT, but unable to recover input VAT), this would be an expensive and high-deadweight way of meeting our commitment to not having VAT on stamps. And it would not be welcomed in respect of services such as

fast parcels where the main customers are taxable businesses so both operators and customers prefer taxation to exemption. However, few member states are likely to accept an outcome that would be "worse" – in terms of the principle that VAT should apply to all goods and services except where there is a specific reason otherwise, in revenue terms, and worse for some markets where the ability to recover input tax is key to sustaining competition – than is necessary to fulfil social objectives (and, in the Commission's eyes, worse than the status quo).

b. **Retain VAT-exempt status for a defined group of core, or basic, postal services – including stamps – and extend this to any providers of similar services.** We would have to give further consideration to how best to define the boundary, but there are several options including exempting postal services which either: are provided under the universal service obligation (USO); carry the option of a reduced rate in the Commission proposal – which is expected to be almost all items under 2kg; or are not open to competition.

This is our recommended option. It could maintain the status quo for basic consumer postal services while removing competitive distortions at acceptable cost (between -£190m and around +£350m, depending on scope of exemption), and is more likely to be negotiable on principled grounds than other options. Further detail on pros and cons of different ways of defining the boundary are at annex C; if you agree this is the best approach to adopt, we will come back to you with further detailed advice.

c. **Retain VAT-exempt status for services provided by Royal Mail under the USO, but similar services provided by other providers would remain taxable, with Royal Mail's other services also becoming taxable.** Our legal advice is that this would probably be defensible on the grounds that Royal Mail's universal services are provided under a specific regulatory and price framework that does not apply to its competitors, meaning that the provision of the universal service by Royal Mail is sufficiently dissimilar to services provided by its competitors to justify a different VAT treatment. However, the sustainability of this position may be

undermined by the outcome of the Danish ECJ case (paragraph 4), chances of successful legal challenge are higher than with option (b), and we may remain exposed to criticism of lack of commitment to liberalisation. In addition, this option would carry the drawbacks of tying an exemption to the USO, considered in annex C. On the other hand, this may be the narrowest exemption option and could be expected to raise revenue (amount depends on scope of USO – see annex C).

10. We recommend pursuing option (b). This would retain VAT-exempt status of stamps, is consistent with postal services liberalisation, and could still allow taxable businesses the benefits of reclaiming input tax on most of the business postal services they use.

11. While we are clear that the primary objective must be to avoid any scenario in which VAT is levied on all postal services, we may not find that all Member States are lined up behind our proposal (Annex D sets out where they are coming from), so this could require hard selling possibly with ministerial input.

12. While several other Member States, in addition to the UK, appear to exempt services provided by their national operator while taxing the same services when provided by the national operator's competitors – and therefore face similar risks of legal challenge as the UK does – most Member States have reserved their positions and none has expressed a clear intention to oppose the Commission's proposal. Although France has suggested they are unlikely to oppose the removal of VAT exemption, they have in the past been seen as opponents of liberalisation. Greece and Portugal have indicated that they may oppose VAT on letters. But it is possible that the UK may be alone in opposing the Commission proposal, as other Member States may be able to live with the principle of taxation with the option of a reduced rate. Once the proposal is published we intend to seek firmer understanding of other Member States' views and will try to build support with those who might have similar concerns.

13. In the instance that other Member States refuse to sign up to a UK counter-proposal, there would be two broad negotiating options we could move to:

a. Veto the proposal. This would leave us exposed to legal challenge, which would be likely to force us to narrow the application of VAT exemption – in a way which would be in the gift of the courts – probably either (at best) to only those services provided by the Royal Mail under their USO, or to those services not open to competition. We would have no vires to extend the exemption in any way.

b. Negotiate a super-reduced rate (i.e. between 0 and 5 per cent at Member States' discretion) of VAT for basic postal services – rather than the reduced rate the Commission will propose – such that the overall burden of VAT on basic postal services remains constant or falls (because providers could recover the VAT on inputs they purchase by moving from exemption to taxation, which could completely offset or even exceed the VAT they become liable for at a super-reduced rate). Further details on how this might work are at Annex E.

14. We believe it would be prudent not firmly to rule out either of these options at this stage.

Impact of any change on services to the consumer

15. Any change to the status quo would have business impacts both on Royal Mail and their competitors, and we would need to ensure that any VAT changes did not undermine Royal Mail's restructuring plan or solvency. However, we think these risks are small – and certainly smaller than many other challenges the company faces – and, in accordance with the wider liberalisation agenda, the key concern should be the impact on consumers. There are five main groups of UK postal services customers:

a. Private domestic users (15% of market for Royal Mail's main postal services) – cannot recover VAT, and mainly use the

sort of postal services that may be considered "basic postal services", including stamps.

b. Charities (2% market) – cannot recover VAT, and often use business type postal services e.g. for bulk fundraising mailings.

c. Businesses who cannot recover (all their) VAT – either non-VAT registered small businesses (4%), or exempt businesses (25%) e.g. banks and insurers who are big users of postal services.

d. Government departments (9%) – cannot recover VAT but part of Government money-go-round so any increased costs could be resolved through funding.

e. Taxable businesses (44%) – can recover VAT and are therefore advantaged by postal services being taxable.

16. The options already discussed go some or all of the way to protecting private individuals from price increases. If you are also interested in protecting charities from any postal service VAT impact, we recommend that once you have given a steer on the broad negotiating stance, we do further work on options for a carve-out for charities if necessary.

Line to take

17. The current line to take anticipates the Commission proposal being published, so will not be appropriate once this has happened. Proposed lines to take reflecting the approach recommended in this submission are at annex F.

18. **Are you content with:**

- our recommendation to negotiate for a continued VAT exemption for core postal services, and for a new exemption for similar services by other providers; and

- the proposed media line (annex F)?

Anna Silvester
Tax Policy (indirect taxes)

Cc: list

CST, info
EST, info
FST, info

Gus O'Donnell
Robert Culpin
Jon Cunliffe
James Sassoon
Ivan Rogers
John Kingman
Melanie Dawes
James Close
Andrew Lewis
Katy Peters
David Richardson
Michael Ellam
Neil Murphy
Tim Johnson
Michael O'Connor
Clare Thorpe
Jonathan Mills
Mark Wright
Billy McKenna
James Bowler
Richard Hughes

Alison French (HMCE)
Richard Brown (HMCE)
Sabine Mosner (HMCE)
Damian McBride (HMCE)
Andrew Jackson (HMCE)
John McCloughlin (HMCE)

James Robertson (UKREP)
Peter Curwen (UKREP)

Ed Balls
Spencer Livermore
Chris Wales
Shriti Vadera

Annex A: Ministerial statements on VAT and post

18 February 1999 : WA 93

Lord Stoddart of Swindon asked HMG whether they will veto any proposal by the EU to impose VAT on postal services.

The Minister of State DTI (Lord Simon of Highbury) : The Government will give careful consideration to any proposals by the Commission taking account of liberalisation of postal services across the EU and the reform package announced by my honourable friend the Secretary of State for Trade and Industry on 7 December 1998.

Lord Stoddart of Swindon asked HMG whether recent increase in the cost of letters to other EU countries from 26p to 30p was in response to EU proposals to levy VAT on postal services; and what public consultation took place prior to this increase.

Lord Simon of Highbury : No proposals have been received from the European Commission on the levying of VAT on postal services…

Answer continues with reference to increase in costs, due to handling costs, consultation procedure etc.

News of the World piece "EU wants to tax our stamps" (5 March 2000)

This article included comment from "senior Treasury source", "*there's no question of accepting VAT on stamps. We intend to keep Britain's veto on all tax matters*".

In response to the above article a letter was sent to the News of the World from Keith Vaz - Minister for Europe:

"*The News of the World on 5 March claimed that the European Commission intended to impose VAT on stamps in order to improve competiton between public and commercial postal services.*

"The Commsission cannot impose taxes. Tax is an issue where all Member States have to agree on any change. Britain has made it clear that it will not accept VAT on stamps.

"The UK agrees however, that competition between the Post Office and other carriers must be improved. The Postal Services Bill, currently going through Parliament, will tackle this distortion".

Ministerial correspondence from PMG (Dawn Primarolo) March and April 1999

"The existence of distortion of competition within the postal sector and the scope from liberalisation of postal services across the EU have been recognised by the European Commission. The Government will give careful consideration to any proposals the Commission may make for change, taking account of the reform package announced on 7 Dec 1998".

3 April 2000 : Column 1077

Baroness Miller of Hendon asked HMG what response they intend to make to the European Union proposal for VAT on postal services.

Lord McIntosh of Haringey : My Lords, The Commission has not yet made a proposal for VAT on postal services

Baroness Miller of Hendon : My Lords, I understand from the discussion paper that the Commission is considering doing so. It has been a year since the noble Lord, Lord Simon, responded to a Question from the noble Lord, Lord Stoddart. Have the Government comne to a conclusion as to what they will do if a firm proposal is put forward, as seems likely?

Lord McIntosh of Haringey : My Lords, we do not know what the proposal will be. If the noble Baroness is concerned that we will accept a tax on stamps, I can say that that is a decision which required the unanimous agreement of all member states. The Government have made clear that they will not give their agreement to such a tax.

Further question on market-opening

10 February 2003 - Column 503W

Mr. Yeo: To ask the Secretary of State for Trade and Industry

(1) when she was first informed of the proposals to require member states to levy VAT on all postal services being discussed in the European Commission; and what representations she has made to the Commission in response to the proposal; [93796]

(2) what assessment she has made of the impact on the Royal Mail of the imposition of VAT on postal services; [93795]

(3) if she will make a statement on the level of VAT on postal services. [93797]

Ms Hewitt: No formal proposals have yet been made to alter the current EC wide VAT exemption for public postal services.

Annex B: Speeches by the Chancellor referring to liberalisation of postal services

3 February 2003 speech to the Social Market Foundation at the Cass Business School, London

A MODERN AGENDA FOR PROSPERITY AND SOCIAL REFORM

Indeed when privatisation took place there was often a failure to put in place the conditions for effective markets. Instead utilities were privatised rather than liberalised and the old monopolies returned this time but in the private sector.

Our view has been that utility reform must promote a market economy (and not just a privatised economy) and that we liberalise where possible and regulate where necessary so that the needs of the consumer are best advanced.

So while some still say we should be anti market and re-nationalise, in these areas our values can best be advanced through markets working in the public interest. So this is our approach to utilities:

- **we are opening up to greater competition utilities like** water and **postal services**;
- as markets fully develop we will withdraw unnecessary regulation while never putting at risk opportunity and security for all;
- we will ensure that the new consumer watchdogs now in place – for example Postwatch, Energywatch and Water Voice - represent and empower consumers effectively; and that regulators make regulatory impact assessments - including effects on competition - standard practice for all significant new proposals;
- and **we will press in Europe for the same liberalisation for energy and utility services: at all times our approach shaped by our view that the public interest can best be guaranteed with market means of delivery through the price mechanism**.

10 March 2003 speech to the Centre for European Reform at Church House, London

THE ROAD TO FULL EMPLOYMENT: ECONOMIC REFORMS FOR A MORE FLEXIBLE AND DYNAMIC BRITAIN AND EUROPE

And it is right to demand the same liberalisation throughout Europe to make the single market work. Britain has learned much from the steps taken in the European Union, before and after the Lisbon agenda, that promote liberalisation and economic reform. And we have supported wholeheartedly

the attempt to restrict the wasteful use of state aids that prevents markets functioning well.

Yet while in 1988 Cecchini estimated that single market liberalisation would add 4.5 per cent to Europe's GDP, cut prices by 6 per cent and increase employment by 1.75 million, many of the gains have yet to materialise. The way forward is mutual recognition of national practises not harmonised regulations; and tax competition not tax harmonisation.

So we support

- A more proactive EU competition regime furthering a strong and independent competition policy for Europe;
- Investigations into particular European markets and sectors to drive up competition and prevent British firms from being excluded from European markets from energy and telecommunications to agriculture;
- **Faster progress on the** reform of airport slot allocation and **liberalisation of postal services**;
- And support for private finance initiatives in Europe.

Annex C: Defining the boundary of a postal services VAT exemption

The Universal Service Obligation (USO)

EC legislation defines universal services in terms of essential characteristics. However, it is left for Member States to decide precisely which postal services are provided as universal services. At present, there is no agreement as to which of Royal Mail's services are provided under its USO, and this definition is to be determined by the independent regulator, PostComm (following consultation – no official timetable yet but PostComm expect to launch consultation in the next month or two which may last a year – or more). Until then, if VAT exemption was tied to the USO, we could not be sure which services would be included in exemption (although we could be reasonably confident that delivery of lightweight, non-business mail would be among them).

Definition of the USO could be changed over time (effectively placing scope of VAT exemption within PostComm's gift, although they are obliged to consult on proposed changes).

Notwithstanding the risk of PostComm defining the USO narrowly (at the extreme, excluding 1st class mail), this could be a good option since there are certain obligations attached to the USO which can justify a favourable tax treatment. It also avoids problems of the exemption necessarily diminishing over time (as the area not open to competition is set to do), the potential high cost of exempting widely defined standard postal services, or competition issues between services on either side of the borderline between standard (exempt) and taxable services.

Postal services carrying the option of a reduced rate in the Commission proposal

Most recent indications are that the Commission will propose that Member States should have the option of applying a reduced rate to, "Standard postal services relating to any addressed envelopes or packages of ordinary correspondence, direct mail, books, catalogues and newspapers, where that item individually weighs no more than 2 Kg, that being a fixed ceiling for the purposes of exercising this option."

Standard postal services would be defined as, "The traditional basic service supplied to the sender of the mail, including deliveries in the fastest standard category, where more than one category exists, and the delivery of items registered or recorded, but not any express delivery services or services provided by sub contractors, or any services relating to terminal dues within the meaning of Article 2(15) of Directive 97/67/EC. An addressed envelope or package is one on which is marked a named person at a given address."

Customs and Royal Mail are giving further consideration to what this would be likely to mean in practice. It appears it would include most if not all services that Royal Mail currently provide for items up to 2 Kg (it may even include Parcelforce services – express parcels – as "express delivery services" might refer to courier rather than 24 or 48 hour services). Tying an exemption to such a definition might in practice be little different from exempting all postal services, and therefore protect charities, exempt businesses and other customer groups who cannot recover VAT from price increases, as well as individuals. However, it would also therefore have greater cost – up to the cost of exempting all postal services estimated at around £191m.

Services not open to competition

As liberalisation progresses, fewer and fewer services will be not open to competition (around 60-70% of the market now, around 30-40% from 2005, and probably meaning all services including stamps being taxable from 2007).

Annex D: How other Member States apply the VAT exemption currently, their market opening strategies and their likely responses to the Commission proposal.

Member State	*Reserved area of postal market*[1]	*VAT Exemption*	*Possible response to Commission's proposals*[2]
United Kingdom	Full market opening by 2007 (2 years faster than EU).	All Royal Mail services exempt.	
Austria	As per EU Postal Services Directive.	No data available.	Not known. But, have previously supported the Commission's liberalisation drive.
Belgium	As per EU Postal Services Directive.	Monopoly services provided by national operator exempt.	No strong interest. Unlikely to oppose.
Denmark	Generally as per EU Postal Services Directive.	National operator's "public interest" services (letters up to 2kg parcels and express services up to 20kg) provided under its obligation to convey mail are exempt. All other services, including all services provided by competitors = taxable.	Not known. Aware of political difficulties, but acknowledge that proposals would help to create a level playing field.
Finland	No reserved area –	No exemption – VAT	Unlikely to oppose

[1] All Member States must liberalise their markets in line with the 2001 postal services directive. This was passed by a large qualified majority of member states and provides for the 'reserved area' for the universal service provider to be reduced to:

- 100 grams from Jan 2003;
- 50 grams by 2006;
- Abolish the reserved area by 2009, subject to further agreement by Member States.

Postcomm's (the UK regulator) market opening plans provide for the market to be open by type of post, rather than simply through reduced weight thresholds alone. Postcomm intends to fully liberalise the UK postal market by 2007, at least 2 years ahead of the Commission's timetable.

[2] Data based on initial responses to a FCO telegram issued in autumn 2002. Most Member States reserved their position and the Commission's VAT proposals have changed since late 2002, so this data should not be interpreted as providing a definitive answer. It is at best an informed guess at their likely position.

	licensed competition with entry fee. However, no real competition to the national postal operator.	on all services.	given domestic VAT position.
France	Universal services within reserved area permitted under EU Postal Services Directive.	National operator's letter, parcel and express services, provided under its universal service obligation are exempt. All other services, including all services provided by competitors = taxable.	Have indicated that they would be unlikely to oppose, but have previously been seen as opponents of liberalisation.
Germany	Generally as per EU Postal Services Directive for letter services. Courier, express and parcel services generally liberalised.	National operator's letter and parcel services provided as part of universal service are exempt. All other services provide by competitors = taxable.	Have previously supported Commission's postal liberalisation proposals. Could possibly be leading (with the Netherlands) support for the Commission's proposal.
Greece	Generally as per EU Postal Services Directive for letters. Licensed competition for small packets and parcels.	All National operator's letters and parcel services are exempt. All serviced provided by competitors = taxable.	Have indicated that they may oppose VAT on letters.
Republic of Ireland	As per EU Postal Services Directive.	All services provided by national operator are exempt. All services provided by competitors = taxable.	Suggested that may oppose, but no firm position as yet.
Italy	As per EU Postal Services Directive.	All services provided by national operator are exempt. All services provided by competitors = taxable.	Unlikely to oppose provided that reduced rate can be applied to all basic universal postal services.
Luxembourg	As per EU Postal Services Directive.	All services provided by national operator are exempt. All services provided by	No position stated.

		competitors = taxable.	
Netherlands	As per EU Postal Services Directive.	National operator's monopoly universal services and other parcel services, when these are charged at a single letter/parcel rate are exempt. All other services, including all services provided by competitors = taxable. Special competition rules, concerning VAT treatment and discounts for bulk mail services.	Strong supporters of liberalisation would indicate that they are likely to support the proposal.
Portugal	Public Services (defined by government) - presumably subject to the EU Postal Services Directive.	All public services provided by national operator are exempt.	No firm position but initial view is that different VAT treatment for public postal services and other providers as justifiable with reference to universal service obligation of national operator.
Spain	No reserved sector, but licensed competition with entry fees. In practice competition exists only in urgent packet and urban letter markets.	National operator's universal services (defined in law) are exempt. All services provided by competitors = taxable. (Currently subject to Competition Court review).	Not known. But are aware that present exemption may be anti-competitive and have concerns about domestic legal challenges.
Sweden	No reserved sector– licensed competition. No real competition to Sweden Post, which has retained over 90% of mail volumes.	No exemption.	Unlikely to oppose.

NOTES

1. Most information gathered prior to 01/01/03. Where the reserved area of the postal market exceeded that permitted under the EU Postal Services Directive on 01/01/03 (100g and 3 x public tariff), it has been assumed that the reserved sector has been reduced in accordance with the requirements of the Directive.

2. The following Member States, in addition to the UK, appear to exempt services provided by its national operator while taxing the same services when provided by the national operator's competitors:

Germany
Greece
Ireland
Italy
Luxembourg
Netherlands (see below)*
Spain

However, in the Netherlands special competition rules apply under which the national operator is prohibited from offering VAT exempt bulk mail services at a price discount. If a price discount is offered by the national operator, the service must be taxed.

Annex E: Super-reduced rates of VAT

Since postal services are VAT-exempt (not zero-rated) the price of postal services charged by Royal Mail already reflects the costs of their non-recoverable input tax – i.e. stamps already bear some VAT costs. Making services taxable rather than exempt would allow Royal Mail to recover its input VAT. A rate of VAT at which the output VAT charged equalled the input VAT that becomes recoverable would not necessitate any change to prices. A rate below this figure would, in fact, theoretically allow reductions in the price of postal services, while a rate above this figure would create pressure for price rises.

More work would be needed to determine the precise price-neutral VAT rate, but initial figures suggest that it would be below 5 per cent, which is currently the minimum reduced VAT rate permitted. However, we could argue for Member States to be given the option to set a super-reduced rate of VAT for (certain) postal services (i.e. between 0 and 5 per cent), at which rate the prices of postal services would not need to increase.

Clearly, this would not be transparently "no VAT on stamps", and is no more than a possible fallback option. But we believe it may be a less unpalatable solution than any that might be imposed by the British courts if we vetoed the proposal altogether.

Zero-rates

A zero rate of VAT could clearly be an attractive proposition for the UK. Theoretically it could enable price reductions, since it would charge no tax to the consumer and yet allow Royal Mail to recover its input tax. However, while in the UK we tend to conceive of zero rates as a rate of VAT set at zero, the rest of Europe instead has the concept of two types of exemption – with and without input tax recovery. The current exemption for postal services is an exemption without recovery, and the Commission would therefore be likely to regard a zero rate (exemption allowing recovery) as a further move away from, rather than towards, taxation. Furthermore, all our existing zero rates were agreed as transitional provisions, and we do not have vires to introduce new zero rates or widen the scope of existing ones.

Annex F: proposed lines to take

The currently agreed line to take is, "Ministers have made it clear that they will not agree to VAT on stamps although the UK will carefully consider any proposal, taking account of any potential benefits for the British public, businesses and other consumers". This will need to be superseded when a proposal is published.

Given the risk of legal challenge, and the Commission's more recent openness to proposing reduced rates of VAT for certain services including stamps, we recommend that in order to leave some flexibility in negotiations and avoiding a hostage to fortune if we do not succeed in negotiating retaining an exemption, the line to take should be:

"The Government is opposed to VAT on stamps, and [will make this clear/this will the basis of our position] in negotiations in Europe on the [recently published] [title] Directive."

If pressed on differential tax treatment of competitors, we could say, "The Government is fully committed to liberalising the postal services market, and supports the fair tax treatment of all players in the market. At the same time it is important to recognise the important social role played by the universal service and it is justifiable for the tax system to reflect this."

If pressed on whether the UK would veto a Directive if it became clear that it would impose VAT on all postal services, we would propose saying that, "It is too early in negotiations to say whether this would either be necessary or the best option. We would carefully consider all the options, including the use of our veto, taking account of any potential benefits for the British public, businesses and other consumers."

10 DOWNING STREET
LONDON SW1A 2AA

THE PRIME MINISTER

19 March 2003

Dear Colin,

I am sorry I was not able, for reasons I am sure you understand, to join you and your colleagues from the National Federation of Sub Postmasters for the meeting on Monday evening. However, it has been reported to me that you had a useful discussion with John and Stephen about the issues of concern to you.

I know that one of those issues is the information DWP makes available to its customers, in particular the way the Post Office Card Account is mentioned. I am pleased to report to you that DWP now intend to make two important changes to their customer material:

i) to include a reference to the card account in the form that customers fill in to give their account details;

ii) to include a reference to the card account and how to apply for one in the reminder letter that customers get if they do not respond to their first letter.

These are important changes and I believe they show that the Government does listen to the concerns of the NFSP and your members.

Yours ever,

Tony Blair

Mr Colin Baker

From: Geoffrey Norris
Date: 7 March 2003

PRIME MINISTER

cc: Jonathan Powell
Jeremy Heywood
Sally Morgan
Alastair Campbell

MONDAY'S MEETING WITH THE POSTMASTERS FEDERATION

You are meeting on Monday evening with Colin Baker and a delegation from the executive of the NFSP. The NFSP's membership continue to be unhappy about the move to ACT, the prospects for the new Universal Bank/ PO Card Account (which ministers agreed should go ahead as scheduled on April 1) and the future prospects of the Post Office network. Monday's meeting is to demonstrate the continuing high importance we attach to the issue and to underline the significant support we are providing for the network (some £2 billion in total over the next five years). Stephen Timms will join you for the meeting.

Briefing attached:

- **Key points on Government support and funding of the network**: provides a full list of the support we are giving the network (including commitment to prevent avoidable rural PO closures until 2006, £450 million to support rural POs, over £200 million for urban POs, etc). **The basic message is we are doing a lot to help give the network a future, POL is loosing money and we are giving it help, but there can't be a blank cheque**;

- **Universal Banking:** on course for introduction on 1 April. The Government has announced our working assumption is 3 million Card Accounts. The NFSP fears that this is in reality a cap. We haven't set a formal limit on the numbers and chose not to introduce from the start eligibility criteria. We are trying to "manage choice" to get to 3 million. **Need to take care on this – we are not trying to stop people who want and need Card Accounts getting them, but you need to avoid giving any open-ended commitment on numbers. Again there is no blank cheque.**

- **Card account individual cases:** They may raise with you examples of where people of are being allegedly straightforwardly denied a Card Account. Some of the ones they have raised so far have turned out to be true and action has been taken to rectify the error. Inevitably teething problems with any new system, but we welcome NFSP passing cases to ministers and officials and they will be look into to and any mistakes rectified.

- **DWP Customer Information Material: The NFSP also complains about some of the literature issued by the DWP.** Some changse have already been made in response to points made by NFSP. And you can say that DWP has agreed to two further changes (a reference to the card account in the form customers fill in to give their account details and a reference in reminder letters sent to people).

- **Your Guide:** As recommended by the PIU we funded (an expensive £25 million) a pilot "Government General Practitioner" information service. Usage wasn't that good and it looked very expensive to roll out nationally, so wehaven't taken it forward.

GEOFFREY NORRIS

Key points on Government support and funding for the network

The Government regards it as most important that all communities have good access to postal and Government services. By accepting all the PIU recommendations, we have made a concrete commitment to the future of the network. And I can assure you we are committed to delivery.

The PIU vision was of modern network with new business opportunities. It also demonstrated how far the network had declined over a long period. Changing lifestyles, changes in customers' preferences and new ways of doing business all need to be addressed. The network must adapt to take account of these changes if its decline is to be halted.

We have put in place a strong management team and challenged them to turn the business round.

Banking and other financial services are central to the Post Office's strategy for the future of the network. Hope to see these being introduced during the course of this year, starting with the delivery of universal banking services in April.

With Government support the network will continue to play its vital social role particularly in rural and deprived urban communities.

The Government is investing very substantial sums in supporting this transformation of the network – some £2 billion in total over the next 5 years. We have:

- Provided £210 million for the urban reinvention programme;
- Made available £15 million for a scheme to support offices invaluable to the community in deprived urban areas throughout England. Similar schemes have been launched in Scotland and Wales.
- Made a firm commitment to prevent avoidable rural closures before 2006.
- Made available a £2 million fund to support community post office initiatives.
- Made available £450m (£150m a year) for the 3 years 2003-04 to 2005-06 to maintain the rural network up to 2006. This money will provide direct support to rural post offices and maintain front line services in local communities, where they would not otherwise be provided on a commercial basis. It will also give Post Office Limited the financial flexibility to pilot modern, innovative ways of delivering services in rural areas.
- Invested £480 million in the Horizon project, one of the UK's largest computerisation projects, which has automated every post office in the network.
- Invested £25 million in the "Your Guide" pilot.
- And we are investing in universal banking services

Looking beyond the transitional period ahead of us, the PIU recommended that Postcomm should advise the Government on the long-term shape of the rural network beyond 2006. That work is underway. We do not want to anticipate the outcome of that advice. We will be working closely with the Commission, POL and other stakeholders in developing proposals for the network for the longer term.

[NB the rest of the funding from the gilts is to cover POL's historic and ongoing losses until the management of POL can turn the business round]

UNIVERSAL BANKING

- Universal Banking is on course for introduction on 1 April. Post Office has made excellent progress in getting the systems ready. Very important that sub-postmasters deliver their part in the successful delivery of all aspects of banking at post offices.

- 60,000 customers have already chosen to open a Card Account. The issue of Personal Invitation documents to those people will begin on schedule at the end of March.

We expect the Post Office to provide a satisfactory Universal Banking system before the end of March and, subject to any last minute serious problems, UB will go live on 1 April. Andrew Smith is planning to issue invitation documents to customers to open Card Accounts before 1 April so that the system is ready for use on that date (albeit at very low numbers). The 60,000 stockpile will be fed into the process gradually so that the system is not stretched at the start.

- Value NFSP's role in identifying areas where the Government's communications with customers have not been adequate. Where you have identified problems, we have taken action. We are trying hard to ensure that everyone gets the right message about the availability of Card Account and banking services more generally at post offices.

- We have, with your input, developed a very informative suite of literature. You have suggested some further changes to our written material. We will:
  - include a reference to the card account in the form that customers fill in to give their account details; and
  - include a reference to the card account in all reminder letters.

[IF RAISED]

- You raised the wrong information that Mrs Douglas from Irvine received from the Pensions Service. I understand that she has now received full information about the UB service and that retraining of Pensions Service staff has taken place.

Unlike the Basic Bank Account element of UB, Card Accounts can only be used at post offices. NFSP wants to maximise the number of Card Accounts. They suspect that the

Government is trying to minimise them (because of their cost) by failing to explain the choices open to customers fully. Large numbers of subpostmasters have been encouraging customers to opt for a card account – a campaign that the Post Office has been attempting to subdue.

There have been problems with the wrong information getting to customers, generally from those parts of the Government machinery not yet directly involved in the move to UB. NFSP have brought these to our attention and we have put them right – by sending revised information to customers and retraining staff to give the right information.

Whilst they concede that they are broadly happy with our literature, the NFSP have asked some of our paperwork to be changed to ensure Card Account gets mentioned specifically at all stages of the conversion process. They would like some changes that would effectively promote the Post Office card account , which we cannot accept. The concessions we are making on the mandate form and the reminder letters should satisfy them.

Motherwell Pensions Centre wrote in February 2003 to Mrs Douglas mistakenly saying the Post Office card account had been abandoned. The Centre was recently opened and has a high percentage of inexperienced staff. Training on Direct Payment included references to the abandoned 'benefit payment card'. Mrs Douglas's enquiry was mistakenly thought to have been about this rather than the Card Account. A letter of apology, correcting the error has been sent to Mrs Douglas. A further letter of explanation was sent on 7 March. The Pensions Service is confident this was an isolated incident. All staff have been issued with the Direct Payment Key Information Pack and reminded of the correct position.

- Customers have the choice to select a Card Account if they wish. There are no eligibility criteria and no cap on the number of Card Accounts.

[If pressed]

- UB has to meet the needs of benefit recipients, but it is also important that the migration of benefit payments to ACT delivers value for money to the taxpayer. Our expectation is that this can be achieved without eligibility criteria or a cap. If the position were to change we would, of course, consult widely.

The Government has announced that its assumption is that 3 million Card Accounts will be created. The NFSP fears that this is in reality a cap. There is no upper limit to the number of Card Accounts that can be set up and the Government chose not to introduce eligibility criteria to restrict access.

However early indications suggest that numbers could be much higher as more customers than expected select this form of payment. This has cost implications for the Government. UB is expected to create significant savings for the paying Departments and these savings have been factored into their financial settlements. If numbers rise significantly higher than 3

million DWP in particular will face financial problems. We will have to look again in the next few months at the emerging trends to decide whether measures such as eligibility criteria might be needed.

- Understand you are concerned that casual agents will not be able to collect benefits on behalf of someone else with a Card Account. Current arrangements, although flexible, are vulnerable to order book and girocheque fraud.

With order books, a customer can easily authorise another individual – a casual agent - to collect their money from the post office by signing the back of an order book foil or girocheque. The ease of this approach creates an important fraud risk. Card Account will increase security by requiring the account-holder to key in a PIN number when the card is handed over. DWP estimate that between 300,000 and 400,000 people have to use the casual agency facility (because of mobility problems, being in hospital etc.) - others use it for convenience.

[IF RAISED]

- The Post Office is working to ensure their services are as accessible to as many customers as possible and have been working with independent consultants specialising in usability and accessibility issues. The Post Office has also invited disability groups to address the concerns that have been raised.

- There have been some concerns expressed by disability groups that the PIN pads do not meet the needs of the visually impaired. Understand that Post Office selected a PIN pad that is already widely used without any problems, but that it is committed to find ways to improve provision.

Concerns have been raised by the RNIB and other disability groups about access to the Post Office card account. The lobby has at times threatened the Post Office and subpostmasters with legal action for failing to provide adequate access, although no such challenge has materialized as yet.

The PIN pads that have been installed are widely used across Europe and elsewhere without problems. Nevertheless the Post Office has committed to three things to meet the needs of their customers:

- to improve the current PIN pads by fitting a guard over the buttons to help guide customers;

- to provide further training for sub-postmasters and Post Office staff to enable them to help customers;
- and in the longer term look at technological options to provide a secure alternative to PIN pads for people with disabilities.

For those who will not be able to be paid directly into an account the Government will develop a straightforward and secure alternative payment mechanism. Its design will be based on the experience of real customers with the new system. The alternative arrangements do not need to be available for some time, as customers who cannot cope with the new arrangements will for the present be able to keep their order books

DWP Customer Information Material

The NFSP have had an important role in shaping DWP's communication products (leaflets and call centre scripts etc). We value this input, and the changes that have been made in response to NFSP comments shows that DWP are listening. For example:

- DWP changed their leaflets in response to NFSP comments so that
    - the option of collecting your money from the Post Office was described in a more positive way;
    - references to the card account were made clearer;
    - the option of opening new accounts (including those that can be used at Post Offices) was made clearer.

- 30 out of 39 NFSP comments on the Call Centre Scripts were taken on board, including:
    - more frequent, more positive and clearer references to the card account.

DWP now intend to make two important further changes to their customer material:

- including a reference to the card account in the form that customers fill in to give their account details;

- a reference to the card account and how to apply for one in the reminder letter that customers get if they don't respond to their first letter.

DWP will also continue to monitor and evaluate the effectiveness of their customer information material and will make further changes if necessary.

DEFENSIVE LINES ON YOUR GUIDE/GGP

- As recommended in the PIU report, the Government provided the necessary funding (£25 million) for the Post Office to test the concept of post offices as "Government General Practitioners". It was made clear from the outset that the decision on whether or not to roll-out a national service would depend on the results of the pilot.

- The Leicestershire and Rutland pilot showed that whilst "Your Guide" was liked and used by some it had limited impact on the lives of citizens. The pilot demonstrated conclusively that it would neither significantly improve Departments' ability to meet delivery or financial objectives nor raise sufficient revenue for post offices. National rollout would have been very poor value for money. We had no option but to decide not to go ahead.

- Your Guide has highlighted a number of areas in which Government Departments might deliver services through post offices in the future and we are exploring these, and potential alternative commercial options, further.

- There is significant commercial interest in placing kiosks in post offices. A commercial kiosk service, based on kiosks in retail outlets -- including some sub-post offices -- will be piloted in Cornwall from later in the spring.

- The pilot has also helped the Post Office to understand better how it can serve members of the public. This has, for example, been especially helpful in informing the approach it is taking to joint work with the Home Office during the consultation exercise on entitlement cards.

DISABLED ACCESS lines to take

The Post Office is working to ensure their services are as accessible to as many customers as possible and have been working with independent consultants specialising in usability and accessibility issues. The Post Office has also invited disability groups to address the concerns that have been raised.

I understand that the PIN pads that have been installed are widely used across Europe and elsewhere without problems. Nevertheless the Post Office has committed itself to a three-point action plan to improve accessibility to the disabled:

- to improve the current PIN pads by fitting a guard over the buttons to help guide customers;

- to provide further training for sub-postmasters and Post Office staff to enable them to help customers;

- and in the longer term look at technological options to provide a secure alternative to PIN pads for people with disabilities.

Customers who are genuinely unable to cope with a pin number also have the option of nominating someone else to collect their money for them. In these cases a second card will be issued if they have opted for the card account at the Post Office. The banks will have similar arrangements for basic bank accounts and all current accounts.

We have always recognised that there will be a small group of people cannot be paid directly into an account. DWP are developing an alternative method to pay this group of benefit recipients, who will in the meantime remain on benefit books and girocheques.

Post Office card account : casual agency facility

[Casual Agents - the facility that allows a customer to authorise another individual to collect their money from the post office. They do this simply by signing the back of an order book foil or girocheque.]

- Current arrangements, although flexible, are vulnerable to order book and girocheque fraud. Never said that we would replicate the current arrangements in the new system.

- The Post Office card account was designed as a straightforward means of receiving and paying benefits and pensions. It was never intended to have a casual agent arrangement. Bank accounts do not have a casual agent facility.

The 'Exceptions Service' *(the alternative payment method for those payments that cannot be made into an account)* will enable people acting as casual agents to collect money from the Post Office.

File CAB

RESTRICTED - POLICY

From:

Helen Fleming
Economic & Domestic Secretariat

Geoffrey Norris
Policy Directorate

PRIME MINISTER

Copies:
Douglas Alexander
Sir Andrew Turnbull
Paul Britton EDS
Jaee Samant EDS
Jeremy Heywood
Sally Morgan
Alistair Campbell
Pat McFadden
William Perrin

28 February, 2003

UNIVERSAL BANK (UB)

Summary

1. UB is due to go live on 1 April. Andrew Smith has sent an update note (attached) that describes the immediate decision that needs to be made on whether to go live. The decision must be made next week to meet operational lead-times within Departments. He also raises the issue of Card Account numbers. He asks for your comments.

2. Andrew Smith recommends the best possible outcome, which is for the UB service to go into operation on 1 April, but at a very low level. Under current plans around 35,000 customers per week would be invited to open Card Accounts in April, rising to 55,000 in mid June and 65,000 in September (although Ministers may decide next week to lower the level of April invitations). The OGC's latest review suggests that this approach would minimise – although not remove entirely – the risks within the project. Ministers will be making a decision on go-live next week without assurance information on all aspects of the service. There is also scope in the next four weeks for something to go wrong. OGC have made it clear that this is not the most prudent way to introduce a major project although they understand that there are important political factors in the decision.

3. There are real risks in making this decision now. However we met the UB programme director this week to review progress on the project and she is increasingly confident that the service is likely to be ready for use on 1 April. If the operation of UB had to be

delayed, the confidence of the stakeholders – banks, sub-postmasters and customers – would be seriously damaged. It could also damage public confidence in the Government's ability to deliver major change projects. **We suggest that you support Andrew Smith's recommendation, subject to his being satisfied that no significant problems are likely to arise with the operation of UB and that robust contingency plans are in place to ensure continuity of payment if any problems arise. A good handling strategy is also needed, whatever the decision.**

4. Beyond 1 April the operation of UB will need to be closely watched to ensure it delivers what was promised. We already know that managing the number of Card Accounts will be a problem (you received a note on this a couple of weeks ago). We will also need to watch the customer-friendliness of some of the processes; and the developing attitudes of the sub-postmasters who are still very sceptical about the benefits, for them, of this change. **We suggest that you ask Andrew Smith to keep all of these issues under review and that he reports back to you on Card Account numbers at the end of May.**

<u>The go live decision</u>

5. The elements that must be in place to allow UB to go live are:

a. Post Office Ltd (POL) must supply a satisfactory Card Account service to the Government

The service is defined in the contract between POL and the paying Departments (DWP, Inland Revenue and the Northern Ireland Social Security Agency) and these Departments that will decide whether it meets the contractual requirements. Although there are still unsettled issues between the parties, it is looking increasingly likely that the paying Departments will be ready to accept the service at the end of March.

b. DWP must start issuing Personal Invitation Documents (PIDs) to customers who have asked for a Card Account

A Card Account can only be opened if a customer has a PID. The PID is presented at the local post office where the customer receives an application form to open the account. Once completed, the form is returned to POL with the PID (as an identity check) and the account can be opened. It is the PID-issue process that will allow the Government to

manage the number of Card Accounts being set up and used – identified by OGC as an important control mechanism in the first months of UB operation.

Andrew Smith's Ministerial group will meet on 5 March to consider whether to authorise PID-issue. The criteria they will consider are:

- *Can customers open and use Card Accounts; are they being given good quality help if needed; and can special circumstances be handled effectively?*

POL's piloting of the Account is giving a good level of assurance on the operation of Card Account. But the pilots will not have identified every type of problem that will arise. This will need careful watching. The paying Departments and POL will monitor emerging problems. If significant, frequent problems do arise, DWP can slow the flow of PIDs to allow the problem to be assessed and fixed. They will need to make sure solutions are customer-friendly – there is scope for overly-bureaucratic solutions.

- *Payments to customers are protected in case of failure*

DWP assures us that this is in place.

- *Can UB operate at maximum volumes?*

Again, we have been assured that testing has been carried out successfully.

- *The management arrangements once UB goes live are satisfactory*

OGC have recommended ways of improving this that will be implemented.

The UB programme director is reasonably satisfied that these criteria will be met and that Ministers will be able to take a decision to go live on this basis.

DWP's current plan is to issue around 35,000 PIDs in the first week of operation, but the Ministerial group will also have to decide next week whether this number should be reduced. They will need to reach a judgement on how to balance the tension between the objectives of reducing risk and ensuring that enough customers are flowing into the system to ensure post-masters are starting to familiarise themselves with it.

c. The banks must allow basic bank accounts (BBAs) to be accessed at post offices

The systems are in place to do this and a pilot has been running successfully for several weeks in Leicestershire and Rutland. But the banks will want to be sure that DWP is

issuing PIDs before they switch on BBA access. They would not go it alone given their mistrust of the Government's plans for the balance of Card Accounts and BBAs.

The impact of delay

6. If the Government thinks that the risk of issuing PIDs in order to activate UB is too high, the system will not go live on 1 April. The decision would have to be announced. Care would be needed in handling the banks who might be suspicious of the government's motives in delaying. The change of plan would confuse benefit customers who have already started the conversion process. Although these are a small proportion of the total benefit population, individual experiences could be used to embarrass the Government.

7. A more difficult problem would be the attitudes of POL and the National Federation of Sub-postmasters (NFSP). If POL had provided a contractually acceptable service, they would want the Government to halt its conversion process. Their concerns would be that benefit customers would be more inclined to adopt a banking option in the absence of UB; and that it would become more difficult for them to manage sub-postmaster expectations.

8. The NFSP membership is deeply worried about the negative impact of payment modernisation on their business and has not yet been convinced that UB is a viable alternative. The wider context is that business is steadily declining and planned (under the network reinvention plan) and unplanned closures are still taking place. The leadership of the NFSP has only just managed to halt plans for a campaign against UB. Members are currently considering an offer from POL (which has been recommended by the leadership) on remuneration for administering UB. A delay would exacerbate their concerns and make it much more difficult for the Government to introduce UB successfully. From the paying Departments' perspective, delay to the conversion process means lost savings which are factored into their current financial settlements. The Treasury would need to agree to revisit these settlements if halting the conversion process became desirable.

Conclusion

9. A decision next week to activate the UB service from 1 April is not without risk. We do not yet have full assurance that the system will work as planned although we have

evidence that the components of UB are operating satisfactorily. But April 1 has become a key date for the stakeholders, whose continued participation is absolutely critical to success. The evidence suggests that, absent any last minute problems, the risk of going live with a low number of customers on 1 April is acceptable. In view of this and given the need to keep the stakeholders engaged, we recommend that you agree with Andrew Smith's plans. Whether or not UB goes live, a good media handling strategy is vital. UB is high profile and problems in operation will be picked up quickly. Douglas Alexander is involved in the Ministerial decisions.

Longer-term issues

10. The primary longer-term issue is the higher-than-expected selection of Card Accounts by customers. Andrew Smith blames this entirely on locally campaigning sub-postmasters trying to protect their business. This is certainly a factor in some decisions. But the absence of hard information on the alternatives open to customers so far might also have had an important role. Card Account would certainly look like the option closest to the current system for customers nervous about the change. Until DWP has done some research on the choices of the first customers (which it is planning), we will not know for sure. It would be premature to make any decisions until the situation is clearer. We suggest you ask for a report back in late May.

11. There are also issues about the customer experience of UB. Some of the processes – e.g. arranging for someone else to collect benefit on your behalf – are lengthy and demanding, in particular for vulnerable customers. There is a tension between making the service user-friendly and reaching objectives to reduce fraud. It may be necessary to tweak processes as the service rolls out.

Helen Fleming

Geoffrey Norris

JH

cc GN
JJ
DS
AMS

RESTRICTED – POLICY

Prime Minister

UNIVERSAL BANKING

Summary

Progress continues to be made, and looks likely that universal banking services will be available at post offices from April. But there is still a risk that post offices will not be ready in time. MISC19 will have to decide, by 7 March, whether:

- **We have enough confidence that the Post Office is going to be ready in early April, to continue with our current plans to invite people to open Post Office card accounts from then; or**

- **Whether we move to our contingency plan, (which has an operational lead-time of around 4 weeks), and inform people that we are not totally confident that universal banking will be ready on time, so we are going to defer inviting customers to open card accounts until we are sure.**

Both options carry risks - we will have to make a fine judgement in the light of all the information available at that point. Meanwhile, unauthorised sub-postmaster activity is distorting customers' choices,

with a large potential cost to Government. I have asked MISC19 to explore whether other sources of funding for the Post Office should be reduced to take account of any universal banking windfall. This might incentivise Post Office management to tackle unauthorised sub-postmaster activity and would protect the Exchequer interest.

We face some difficult decisions in the new few weeks. It would be helpful to have your views to feed into the decision-making process.

1. Since I last wrote to you about universal banking, a good deal of progress has been made by all the delivery programmes:

- The Post Office have virtually completed the roll-out of PIN-pads in post offices, and are progressing well with testing the IT systems on which universal banking will depend;

- The paying Departments are well advanced with writing to their customers inviting them to change their method of payment - the Revenue have completed their mailing; the Veterans Agency mailing programme is nearing completion; mailings to 4-weekly paid child benefit customers are well underway; and the Pension Service has just started trial mailings to pensioners in the North East, Scotland and Northern Ireland;

- We are monitoring the response to those exercises closely, and can now begin to make some early, tentative predictions about the likely outcome overall : there are some disturbing trends (see below);

- The Post Office's "soft launch" (or pilot) of electronic banking transactions, involving basic bank accounts and Alliance &

Leicester ordinary accounts, is going extremely well;

- Patricia Hewitt and I wrote again to all MPs on 4th February, updating on progress and attempting to correct some misleading press reports.

- The OGC have this week carried out a Gateway review of universal banking and concluded that implementation and migration beginning in April is now a realistic possibility, although not an easy or risk-free decision.

2. Against all this, however, there are two areas of real concern. First, the Post Office's overall readiness for a full national service from April. And, second, the behaviour of some sub-postmasters, and the implications of that for Government policy and finances.

Post Office Readiness

3. Perhaps surprisingly, there is no suggestion that Post Office IT systems will not be ready on time. After missing one milestone at the end of November, Post Office and their lead supplies (EDS) have worked hard to catch up, and are now back on schedule. The indications so far are that the various IT systems involved - which are based on tried and tested technology - will work.

4. The area of concern is not with the IT, but with the front-line staff who need to make a reality of universal banking - and, in particular, the Post Office card account. When the Post Office piloted the process of opening card accounts, it revealed serious problems. Nearly two in every three applications were rejected. Most problems lay in sub-postmasters' failure to check and process application forms correctly. Simply, they had not read their training, and did not do their job properly.

5. There were some extenuating circumstances - the pilot took place over the busy Christmas period. And the purpose of pilots is to highlight problems while there is still an opportunity to put things right. Certainly, the results vindicated our decision last Autumn to go for a slower build up. If the Inland Revenue had pressed ahead with their original plan to issue Personal Invitation Documents (PIDs, enabling customers to open a Card Account) in bulk in January, the result would almost certainly have been chaos at post offices, reflecting badly on both the Post Office and the Government.

6. The Post Office are now pulling out all the stops to put things right, and are now running a second pilot, involving Veterans in Liverpool, to demonstrate that the lessons have been learned. Indications are that this time account opening is going smoothly.

7. In order to accommodate this extra pilot, however, the Post Office have put back the piloting of transactions using the Card Account. That has seriously compressed the timetable leading up to 1 April, and makes it difficult to be confident, at the point where we will have to make operational decisions, about starting to issue PIDs in large numbers. Nevertheless, the Card Account transaction pilot has now started, and early indications are good.

8. MISC19 will consider all of this on 5 March. We will have until 7 March to decide whether to initiate planned contingency arrangements. The choice at that date is between:

- continuing with preparations to issue PIDs in the early days of April on the assumption the Post Office will be ready then. We will have most of the information we would like to support that decision but not all. If we do decide to go ahead, there will still be

a risk that the Post Office will stumble in the last three weeks before go-live and that the service does not work as well as it should after go-live. We are doing all we can to manage and minimise those risks. We will not jeopardise any customer's payments or ability to get cash at a Post Office but there could be some confusion and inconvenience if it went wrong;

- announcing that we are deferring the issue of PIDs until we are satisfied that the Post Office card account service is ready and robust. The banks would, as a consequence, defer making basic bank accounts accessible at Post Office branches, so the go-live of universal banking as a whole would be deferred. The risks attached to this are largely ones of presentation and handling but the fall-out could both impede the modernisation of benefits payments and damage the reputation of the Post Office. And there could be a very small number of customers who could not draw their benefits at the Post Office because they were relying on basic bank accounts.

The judgement will not be straightforward. We continue to explore ways of managing and minimising the risks whichever option we have to choose.

9. Officials are working up the options for the meeting of MISC19 on 5 March. I would prefer to go ahead, on plan, if we have enough evidence to support that decision but it would be helpful to know if you have a preference before the meeting on 5 March.

Sub-postmaster activity

10. The other area of concern is that a significant number of sub-

postmasters, with the encouragement of their National Federation, are openly trying to distort customer choice in favour of the Card Account. This continues to tie the customer to the post office (whereas the other banking options give customers choice). But it does little or nothing to further our objective of increasing financial inclusion.

11. Sub-postmasters are doing this by:

- displaying unofficial (and often inaccurate) posters which compete with official Post Office material;

- getting customers to sign a "pro-forma" saying they want a Card Account;

- advising customers - regardless of their circumstances - to insist on the Card Account and ignore other options.

12. The result has been customer confusion, especially where - as has frequently been the case - this activity has been targeted on customers, including pensioners, who have not yet even been approached by their Paying Department. Between them the Paying Departments have now logged around 10,000 incidents, and the number is on a rising trend.

13. You have previously indicated that we should be robust with sub-postmasters. But it is, of course, for the management of Post Office Ltd to deal with the actions of their agents, and their efforts so far have been ineffective.

14. Partly as a result of sub-postmaster activity, we are failing to get across the message that you can be paid into a bank account and still collect your cash at the post office. Instead, the Card Account is being

seen as the way to retain post office access. And, possibly because of this, we are seeing early indications that the number of card accounts could end up well above the 3 million level which Douglas Alexander put in the public domain as an "operating" assumption, and on the basis of which Treasury funded DWP, IR and NISSA.

15. The implications, if the number of card accounts is inflated in this way, are serious. First, there is a significant cost to Government. In the extreme case, the whole business justification for the changes we are making could be wiped out. Second, we would be open to criticism by NAO and PAC: it is one thing to use taxpayers' money to subsidise bank accounts for people who do not already have them (the basis on which we arrived at the 3 million assumption). It is quite another to subsidise accounts for people who already have bank accounts and, if their present account does not provide post office access, could easily open another one that does. Finally, the Post Office itself will be missing the opportunity to generate new business, and will be focused on merely retaining as many as possible of its existing ones - not a strategy for long-term survival.

16. Our levers on Post Office management are limited in getting them to regulate the behaviour of sub-postmasters. MISC19 has therefore asked officials to explore the scope for off-setting any windfall gain to the Post Office of POCA numbers exceeding 3 million against other grants the Post Office receives from Government or using other levers. Such a mechanism would exert some pressure on Post Office management and ensure that tax-payers' interests are protected. If we were to use such a lever there would no doubt be objections from the Post Office. But such an approach would be consistent with our policy on social inclusion, it would not affect your commitment that people should be able to get their benefits in cash from the post office and the post office would not be

losing out financially. We ought to be able to implement and defend such an arrangement if colleagues across Government agree.

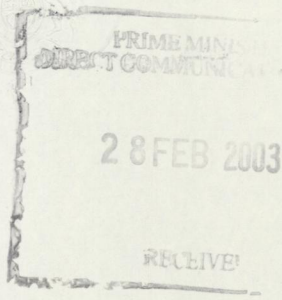
Conclusion

17. Over the next few weeks we face some difficult decisions, and I wanted to give you advance warning now. First, for operational reasons, we will need to decide by early March whether still to go for a launch in April, or to announce a (short) delay. And, second in the slightly longer term, we will need to decide how best to tackle the misinformation put out by sub-postmasters, and picked up by the press and by our political opponents. I will keep you informed.

18. I am copying this minute to Gordon Brown, Patricia Hewitt, Paul Boateng, Stephen Timms, Douglas Alexander, Dawn Primarolo, Lewis Moonie, and to Sir Andrew Turnbull and Peter Gershon.

Andrew .

AS
27 February 2003



RESTRICTED – POLICY

Prime Minister

UNIVERSAL BANKING

Summary

Progress continues to be made, and looks likely that universal banking services will be available at post offices from April. But there is still a risk that post offices will not be ready in time. MISC19 will have to decide, by 7 March, whether:

- **We have enough confidence that the Post Office is going to be ready in early April, to continue with our current plans to invite people to open Post Office card accounts from then; or**

- **Whether we move to our contingency plan, (which has an operational lead-time of around 4 weeks), and inform people that we are not totally confident that universal banking will be ready on time, so we are going to defer inviting customers to open card accounts until we are sure.**

Both options carry risks - we will have to make a fine judgement in the light of all the information available at that point. Meanwhile, unauthorised sub-postmaster activity is distorting customers' choices,

with a large potential cost to Government. I have asked MISC19 to explore whether other sources of funding for the Post Office should be reduced to take account of any universal banking windfall. This might incentivise Post Office management to tackle unauthorised sub-postmaster activity and would protect the Exchequer interest.

We face some difficult decisions in the new few weeks. It would be helpful to have your views to feed into the decision-making process.

1. Since I last wrote to you about universal banking, a good deal of progress has been made by all the delivery programmes:

- The Post Office have virtually completed the roll-out of PIN-pads in post offices, and are progressing well with testing the IT systems on which universal banking will depend;

- The paying Departments are well advanced with writing to their customers inviting them to change their method of payment - the Revenue have completed their mailing; the Veterans Agency mailing programme is nearing completion; mailings to 4-weekly paid child benefit customers are well underway; and the Pension Service has just started trial mailings to pensioners in the North East, Scotland and Northern Ireland;

- We are monitoring the response to those exercises closely, and can now begin to make some early, tentative predictions about the likely outcome overall : there are some disturbing trends (see below);

- The Post Office's "soft launch" (or pilot) of electronic banking transactions, involving basic bank accounts and Alliance &

Leicester ordinary accounts, is going extremely well;

- Patricia Hewitt and I wrote again to all MPs on 4th February, updating on progress and attempting to correct some misleading press reports.

- The OGC have this week carried out a Gateway review of universal banking and concluded that implementation and migration beginning in April is now a realistic possibility, although not an easy or risk-free decision.

2. Against all this, however, there are two areas of real concern. First, the Post Office's overall readiness for a full national service from April. And, second, the behaviour of some sub-postmasters, and the implications of that for Government policy and finances.

Post Office Readiness

3. Perhaps surprisingly, there is no suggestion that Post Office IT systems will not be ready on time. After missing one milestone at the end of November, Post Office and their lead supplies (EDS) have worked hard to catch up, and are now back on schedule. The indications so far are that the various IT systems involved - which are based on tried and tested technology - will work.

4. The area of concern is not with the IT, but with the front-line staff who need to make a reality of universal banking - and, in particular, the Post Office card account. When the Post Office piloted the process of opening card accounts, it revealed serious problems. Nearly two in every three applications were rejected. Most problems lay in sub-postmasters' failure to check and process application forms correctly. Simply, they had not read their training, and did not do their job properly.

5. There were some extenuating circumstances - the pilot took place over the busy Christmas period. And the purpose of pilots is to highlight problems while there is still an opportunity to put things right. Certainly, the results vindicated our decision last Autumn to go for a slower build up. If the Inland Revenue had pressed ahead with their original plan to issue Personal Invitation Documents (PIDs, enabling customers to open a Card Account) in bulk in January, the result would almost certainly have been chaos at post offices, reflecting badly on both the Post Office and the Government.

6. The Post Office are now pulling out all the stops to put things right, and are now running a second pilot, involving Veterans in Liverpool, to demonstrate that the lessons have been learned. Indications are that this time account opening is going smoothly.

7. In order to accommodate this extra pilot, however, the Post Office have put back the piloting of transactions using the Card Account. That has seriously compressed the timetable leading up to 1 April, and makes it difficult to be confident, at the point where we will have to make operational decisions, about starting to issue PIDs in large numbers. Nevertheless, the Card Account transaction pilot has now started, and early indications are good.

8. MISC19 will consider all of this on 5 March. We will have until 7 March to decide whether to initiate planned contingency arrangements. The choice at that date is between:

- continuing with preparations to issue PIDs in the early days of April on the assumption the Post Office will be ready then. We will have most of the information we would like to support that decision but not all. If we do decide to go ahead, there will still be

a risk that the Post Office will stumble in the last three weeks before go-live and that the service does not work as well as it should after go-live. We are doing all we can to manage and minimise those risks. We will not jeopardise any customer's payments or ability to get cash at a Post Office but there could be some confusion and inconvenience if it went wrong;

- announcing that we are deferring the issue of PIDs until we are satisfied that the Post Office card account service is ready and robust. The banks would, as a consequence, defer making basic bank accounts accessible at Post Office branches, so the go-live of universal banking as a whole would be deferred. The risks attached to this are largely ones of presentation and handling but the fall-out could both impede the modernisation of benefits payments and damage the reputation of the Post Office. And there could be a very small number of customers who could not draw their benefits at the Post Office because they were relying on basic bank accounts.

The judgement will not be straightforward. We continue to explore ways of managing and minimising the risks whichever option we have to choose.

9. Officials are working up the options for the meeting of MISC19 on 5 March. I would prefer to go ahead, on plan, if we have enough evidence to support that decision but it would be helpful to know if you have a preference before the meeting on 5 March.

Sub-postmaster activity

10. The other area of concern is that a significant number of sub-

postmasters, with the encouragement of their National Federation, are openly trying to distort customer choice in favour of the Card Account. This continues to tie the customer to the post office (whereas the other banking options give customers choice). But it does little or nothing to further our objective of increasing financial inclusion.

11. Sub-postmasters are doing this by:

- displaying unofficial (and often inaccurate) posters which compete with official Post Office material;

- getting customers to sign a "pro-forma" saying they want a Card Account;

- advising customers - regardless of their circumstances - to insist on the Card Account and ignore other options.

12. The result has been customer confusion, especially where - as has frequently been the case - this activity has been targeted on customers, including pensioners, who have not yet even been approached by their Paying Department. Between them the Paying Departments have now logged around 10,000 incidents, and the number is on a rising trend.

13. You have previously indicated that we should be robust with sub-postmasters. But it is, of course, for the management of Post Office Ltd to deal with the actions of their agents, and their efforts so far have been ineffective.

14. Partly as a result of sub-postmaster activity, we are failing to get across the message that you can be paid into a bank account and still collect your cash at the post office. Instead, the Card Account is being

seen as the way to retain post office access. And, possibly because of this, we are seeing early indications that the number of card accounts could end up well above the 3 million level which Douglas Alexander put in the public domain as an "operating" assumption, and on the basis of which Treasury funded DWP, IR and NISSA.

15. The implications, if the number of card accounts is inflated in this way, are serious. First, there is a significant cost to Government. In the extreme case, the whole business justification for the changes we are making could be wiped out. Second, we would be open to criticism by NAO and PAC: it is one thing to use taxpayers' money to subsidise bank accounts for people who do not already have them (the basis on which we arrived at the 3 million assumption). It is quite another to subsidise accounts for people who already have bank accounts and, if their present account does not provide post office access, could easily open another one that does. Finally, the Post Office itself will be missing the opportunity to generate new business, and will be focused on merely retaining as many as possible of its existing ones - not a strategy for long-term survival.

16. Our levers on Post Office management are limited in getting them to regulate the behaviour of sub-postmasters. MISC19 has therefore asked officials to explore the scope for off-setting any windfall gain to the Post Office of POCA numbers exceeding 3 million against other grants the Post Office receives from Government or using other levers. Such a mechanism would exert some pressure on Post Office management and ensure that tax-payers' interests are protected. If we were to use such a lever there would no doubt be objections from the Post Office. But such an approach would be consistent with our policy on social inclusion, it would not affect your commitment that people should be able to get their benefits in cash from the post office and the post office would not be

losing out financially. We ought to be able to implement and defend such an arrangement if colleagues across Government agree.

Conclusion

17. Over the next few weeks we face some difficult decisions, and I wanted to give you advance warning now. First, for operational reasons, we will need to decide by early March whether still to go for a launch in April, or to announce a (short) delay. And, second in the slightly longer term, we will need to decide how best to tackle the misinformation put out by sub-postmasters, and picked up by the press and by our political opponents. I will keep you informed.

18. I am copying this minute to Gordon Brown, Patricia Hewitt, Paul Boateng, Stephen Timms, Douglas Alexander, Dawn Primarolo, Lewis Moonie, and to Sir Andrew Turnbull and Peter Gershon.

AS
27 February 2003

HOUSE OF LORDS

Dear Geoff,

27 January 2003

As you know, in August 2001 we reported our independent review of industrial relations in Royal Mail. I'm now writing to you as one of the key players involved in making the report happen. I know that you have since shown great interest in the progress made on the recommendations in the review. You have also signalled your enthusiasm for the efforts made by Royal Mail and the Communication Workers Union to improve a damaging industrial relations situation.

Sadly I have to now write today that I am very concerned about the situation because as you probably know the CWU suspended involvement in partnership working on November 18 2002. Consequently nothing has happened since.

I attach a copy of letter sent to Billy Hayes, General Secretary of the CWU, which spells out my concern in more detail about the issues arising from the union suspension. I am worried that if nothing changes soon we'll lose the goodwill and support of Royal Mail employees and the independent chairs of the Partnership Boards, who are poised to make a significant contribution.

I will meet the CWU Executive on 5 February. If you are able, I would ask you to speak to Billy Hayes or John Keggie (Deputy General Secretary of the CWU) before then and impress on them the need to get back into partnership working at the absolute earliest opportunity.

You can discuss this matter with me (my pager number is 08700 555500 ref 860964) or more detailed information is available from Sue Marsh on 020 7016 2856.

Yours faithfully,

Lord Sawyer of Darlington

Thank you for your letter of 12th December. I look forward to lunch with you and I agree that the Commonwealth Club is a good venue. However, given the way that events have unfolded over the last few weeks I feel it is vitally important that I share some concerns with you. I believe we have come to a critical point in the future of partnership working between the CWU and Royal Mail. The CWU suspended involvement in partnership on 14th November last year. If the situation is not resolved by the end of this month we will be close to a three-month suspension period. At this stage the suspension will be tantamount to a withdrawal.

As you know, when we submitted the initial report in July 2000 I committed to undertake regular public progress reviews. At the end of this month I am due to publish my second review. I am glad to say that it will recognise the achievements that have taken place through CWU and Royal Mail working together on the recommendations in the report. I will also say that there is still a lot of work to be done. I passionately want to avoid saying that the recent actions of the CWU in suspending involvement have put the partnership process at risk. But I feel I will have no alternative if the situation does not change.

I am fully aware of the commitment made by you, John Keggie and the CWU to sign up to the recommendations in the report. I feel now that the CWU is close to breaching that commitment. I know that this was never going to be an easy journey and it is to everyone's credit that progress towards partnership working has continued through some periods of difficult industrial relations. This is one of the main reasons why I find the recent actions so disappointing.

I want to say that this letter should not to be seen as criticising individuals. I do not know where the problem lies. At the meeting I attended on 19th December between the Union and Royal Mail both sides raised concerns about behaviours regarding existing agreements. I understand that work is being done to rectify this but I don't know where this stands. I don't doubt that problems still exist but in my experience this will always be the case and I feel strongly that walking away from partnership won't resolve them. Neither can I understand why using partnership as a hostage gives any benefit to your members who are really gaining benefits from the work being done in partnership.

I know that you are aware of the progress that has been made in the last eighteen months. There are four areas of particular note:

- There are now thirteen Area Partnership Boards and three Regional Boards working together and making a difference.

- There are independent Chairs leading each of the Boards and these people are proving to be a most valuable asset. I will be meeting with the Chairs on 30th January and I want to be able to tell them that their contribution is very much appreciated. It would be tragic to lose their commitment and support.

- There is also a joint approach between CWU, CMA and Royal Mail on improving behaviours that is being signed up to by the Boards and this will provide a real opportunity for postmen and women to get involved and make a difference.

- And finally this is the biggest TUC-supported partnership scheme with government funding of £50,000 and if it fails it will be a blow to the TUC.

I am due to attend a meeting of the CWU Executive Committee on 21st January and I very much hope that the outcome of that meeting will be an immediate resumption of partnership working. I know that John is trying to take things forward but given the difficulties that exist at present I hope that you and he together can unlock this jam.

I know from my experience over the last year that partnership working between the CWU and Royal Mail is a matter of public concern. In the period ahead I will have to respond to those people outside the business who will be concerned at the issues I have expressed in this letter. I'd very much like to speak to you and John at the earliest opportunity and hope we can find a speedy resolution.

Best wishes,

Yours sincerely

Lord Sawyer of Darlington

Cc: John Keggie

10 DOWNING STREET

PM

Unused Banking

To see Andrew T's

note. Technically just

about OK, but politically

the Postmasters are

restless + Colin Baker

wants to come and

see you.

Yours.

Secretary of the Cabinet and Head of the Home Civil Service

PRIME MINISTER

cc Paul Britton
Jaee Samant
Helen Fleming
Geoffrey Norris
William Perrin

UNIVERSAL BANKING

I promised in November to update you on the progress of Post Office Ltd (POL) in meeting their contractual obligations on Universal Banking (UB).

2. A key contractual milestone, due to be completed at the end of November, was missed by around seven working days. EDS failed to carry out on time the testing of the infrastructure that will underpin the new Card Account. Missing this milestone had been expected to be critical to the success of the programme overall. MISC19 met under Andrew Smith's chairmanship to discuss this on Wednesday. They were satisfied by the UB Programme Manager's reassurance that the delay had not been critical. The pilot scheme that will operate Card Accounts has started on time despite the delay. More importantly, the decision made previously by MISC19 to delay the use of Card Account for New Tax Credits means that the process of rolling out account opening will not now have to start in January, as originally planned.

3. There is therefore **no need to revise the start date at present** but Ministers did express concern on Wednesday that they would need good quality and frequent information from the Programme Manager in order to reach sound decisions on whether to proceed as currently planned. There will be a series of operational and contractual milestones in the coming six weeks that will need to be met if the implementation date is to stick.

4. There remain major potential barriers to the successful implementation of UB. One of the most important of these is the attitude of the stakeholders, including POL themselves. David Mills (Chief Executive of POL) and Alan Leighton (Chairman of Royal Mail Group) recently complained to the Trade and Industry Select Committee that their marketing of the Card Account was being hampered by Government and that POL stood to lose £400million of business from payment modernisation (we do not accept this figure). Their evidence has given comfort to the National Federation of Sub-postmasters (NFSP) in their opposition to UB. MISC19 has asked Patricia Hewitt to speak urgently to David Mills to try to persuade him to correct the

impression that POL are no longer committed to UB and their wider business diversification agenda. Without the prospect of new banking business, there is very little to encourage sub-postmasters to stick with the network and deliver change.

5. There is no need for any immediate action on your part. Progress with the programme is being reviewed very closely and MISC19 will meet again in mid January to discuss progress. I will keep you in touch with major developments.

ANDREW TURNBULL
20 December 2002

CROXLEY heritage

file

Secretary of the Cabinet and Head of the Home Civil Service

PRIME MINISTER

cc Paul Britton EDS
Jaee Smith EDS
Helen Fleming EDS
Geoffrey Norris
William Perry
Oly Jones

cc : nbo JSH SV

UNIVERSAL BANKING

You asked me to hold a meeting to review the findings from the Office of Government Commerce (OGC) Gateway Review on the programme to implement Universal Banking (UB). On 22 October I chaired a meeting with Peter Gershon (Office of Government Commerce) and the Permanent Secretaries of the Department for Work and Pensions, the Inland Revenue, the Department for Trade and Industry and the Treasury.

2. The recent OGC Review gave UB Red status, and made two urgent recommendations:

i. Immediate action should be taken to reduce the planned load on the system in the first weeks of its operation: We considered options for an alternative implementation strategy, focusing, in particular, on the large number of planned New Tax Credits payments on 1 April 2003. Making sure that only a very low number of people are using UB in its early days will allow the system to be tested in a thorough way with minimal exposure. It does not, however, completely remove the risk that payments to individuals might fail, with consequent adverse publicity;

ii. Further consideration should be given to extending the planned pilots to conduct a thorough 'shakedown' integration test of the system before being used for real payments: The planned pilots were not designed to assess the capacity of the new system. The pilots were designed to check whether customers and sub-postmasters could use the system effectively. Only a few hundred people were being tested and any extension would involve significant delay to the go-live date. Given that the number of customers now expected to use the system in the early weeks was small, it was agreed that the pilot was adequate although not ideal.

3. We agreed the following actions:

i. DWP and Northern Ireland Social Security Agency (NISSA) would keep to their current payment plans (DWP and NISSA build up card account customers gradually over the first few months), but the Inland Revenue (IR) would pay their card account customers by giro for between 3 – 6 months and then migrate them all onto card account at one time, when the system was known to be robust. The plan would have to be agreed with the Post Office;

ii. The presentation strategy for the project needed considerable work to ensure that the Revenue's deferral of payment by ACT to about 150,000 out of some 5 million customers for a few months was not seen as another Government IT failure. This would need to take into account the perspectives of all the different stakeholders and consider what and how the Government wished to position in the public domain as measures of success;

iii. The pilots should remain in their current format;

iv. The project should be kept under constant review and critical milestones assessed on a regular basis.

4. Ministers met on 30th October to consider the current plans for piloting and proposals for handling early loading. They agreed with all our recommendations. They were however concerned that the proposal to switch 150,000 NTC customers onto ACT in one go would still put pressure on the system. They have therefore asked DWP to do some further work modelling the effects of decreasing or even stopping the DWP migration at the time that NTCs come on stream to alleviate pressure on the system.

5. Ministers agreed that improving the handling strategy was critical, especially because paying departments have begun to receive proforma letters from clients demanding card accounts, prompted by their sub-postmasters.

6. There is a critical systems testing milestone at the end of November that is currently looking at risk – if that slips, the Government will have to consider delaying the start of UB. I shall report back to you at that point and also after the OGC conduct another review of the UB programme in February to assess its readiness for going live in April.

ANDREW TURNBULL
04 November 2002

From: Geoffrey Norris
Date: 1 November 2002

PRIME MINISTER

cc: Jonathan Powell
Jeremy Heywood
Sally Morgan
Martin Hurst

POST OFFICE NETWORK: UPDATE

Attached a short note by the Cabinet Office reporting on the forthcoming announcement of a package of financial support (up to £150 million per annum up to 2006). The aim is to fund our commitment to no "avoidable closures", ie. closures only happen when there is no one willing to take on running the Post Office. The announcement has been delayed by a wrangle over financing with the company. We want it financed out of the gilts (the Post Office's past profits) made available to it over the summer to finance the restructuring. The Post Office says there isn't enough there to pay for restructuring and support rural post offices. We are working to square up the figures – **we don't have any new money for this.**

Beyond 2006 we will need to think about how we can ensure post service services continue to be able in rural communities. A continuing subsidy as the level of £150 million is unattractive and the trends eroding the economics of rural branches look set to continue. Over the next few years we will pilot schemes such as mobile post offices and unconventional solutions (pubs providing post office services) to find ways of providing the services in a more cost-effective way.

More positively POL, the subsidiary running the network, has a new CEO drawn from the banking sector. David Mills is bringing a welcome fresh approach to the network and has produced a plan for improving the range of services on offer through post offices.

THE POST OFFICE

Summary

Patricia Hewitt and Margaret Beckett expect to announce shortly a funding package to support the rural Post Office network. An announcement was scheduled for 4th November but may be delayed because Post Office Limited (POL) has not yet agreed the package. The key elements of the proposed package are:

- The Government continues to meet its commitment that there should be no avoidable closure of rural post offices up to 2006, and makes finances available to POL to support this policy.

- Funding will be provided via a contract between Government and POL managed, until 2006 in the first instance, by DTI. It would require the provision of reasonable access for all citizens to "over the counter" services in rural areas. These services should include financial services, specifically access to cash including pensions and benefits, bill payment, Government transactions and information, and postal services.

- DTI is, in consultation with the Treasury, negotiating a contract for the social network payment within the ongoing negotiations on POL's strategic plan. The costs to Government should be the minimum necessary to ensure reasonable access to services, in the first instance to the end of 2006: DTI estimate that cost to be £150m per annum.

- In the period between now and 2006, POL will be allowed the flexibility to pilot innovative alternative ways of delivering services in rural areas. DTI is negotiating service-access criteria with POL that ensures that an acceptable level of service is provided.

Background

1. POL, a subsidiary of Consignia, which is wholly owned by the Government, runs the network. Roughly half of the 17,500 outlets are rural (i.e. in settlements of less than 10,000 people). 94% of the UK's population lives within a mile of a post office.

2. Despite widespread use of post offices, the network has been reducing in size for at least the last 20 years. After a record year for closures in 2000/1, the position stabilised in 2001-02 close to the 250 a year average, with 74% of closures being rural. The volume of PO transactions has fallen by 17% over the last 5 years. POL has accumulated a debt of some £420m to Consignia as a result of losses in recent years. The debt is expected to increase by more than £300m during the current year and continue to grow thereafter. POL's directors have been given a letter of comfort from the holding company that has led them to conclude that they can continue to operate on a going concern basis. Without that POL would be insolvent.

How much of an impact is the new management team having ?

3. Allan Leighton (Chairman of Consignia) and David Mills (the new CEO of POL) have the full backing of DTI Ministers. David Mills has reviewed the network and has submitted a plan, which DTI think is realistic but highly aspirational and risky. The new management team wants to concentrate on new and profitable products around a financial services core, enhancing the range of offerings for banking and savings services, bill payment, insurance and foreign exchange.

4. Even though the new Consignia management team is starting to get a grip on costs and reforming the business, POL is still losing money. POL's strategic plan for 2002/03 predicted greater losses this year than in the previous year but in fact, losses are likely to be the same or smaller. Their 'Renewal' reform programme to change the delivery and charging structure for post has slipped and the expected savings have not materialised – but this has been offset by one-off housekeeping savings. It will be important however for the reform programme to take effect if POL is to be revived.

What is the proposed new funding package ?

5. POL's Strategic Plan is based on only 2,000 rural post offices being commercially viable. The funding package now being negotiated is in effect the price of keeping the rest of the rural offices open. The funding proposal is intended to maximise the value of support to sub-postmasters without creating a "benefit trap" (whereby successful businesses would be penalised for being so through loss of access to payments).

6. DTI think that the proposed funding can be accommodated within the overall funding package for Consignia, within the gilts held on the balance sheet. At present, they remain at odds with the company about whether the total package can be engineered to fit within the gilts envelope. Consignia believe that the total funds available are not adequate. DTI believe that the package is tight but achievable. Unfortunately, DTI Ministers trailed this package (though not its details) some weeks ago and that may have rather limited their negotiating position.

7. The funding package of £150m per annum up to 2006 breaks down as follows:

- £66m will be used directly to maintain income levels for sub-postmasters (through maintenance of the assigned office payment – AOP- to each office);
- an additional £74m will be used to fund overheads to maintain the front line services necessary for each rural post office to operate – to provide them with IT, cash, forms, direct marketing, and information help line. There will be a 10% efficiency incentive built into this;
- a £10m flexible fund to modernise service delivery and pilot innovative ways of delivering services. POL would be asked to set up a consultative group including the National Federation of Sub-Postmasters (NFSP) and other stakeholders to advise on the use of this fund. DTI think the Federation will welcome this.

Will it work ?

8. The package will not prevent all rural closures but it is likely to keep most of the non-commercial rural offices open till 2006, unless the switch to benefit payment by ACT completely decimates footfall in post offices. At the level of sub-postmasters, the funding (AOP) has been set at a level which effectively requires the sub-postmaster to run a private business alongside the post office to earn a decent living wage.

9. What the Government does beyond 2006 needs to be considered separately – there is far greater flexibility given that the commitment to prevent all avoidable closures of rural post offices is only till 2006. Officials will shortly begin the process of exploring the options for providing services beyond 2006 as soon as the short-term package is agreed, including looking at service delivery based on need (rather than on numbers of offices) and in the context of cost effective service delivery.

Economic and Domestic Secretariat
31 October 2002

FAXED
7/10.

From: Jeremy Heywood
Date: 7 October 2002

HELEN FLEMING

cc: Sir Andrew Turnbull
Geoffrey Norris
Carey Oppenheim
William Perrin
Oliver Jones
Paul Britton
Jaee Samant

UNIVERSAL BANK (UB)

The Prime Minister was grateful for your minute of 27 September. He strongly agrees with your advice. He would be grateful if Sir Andrew Turnbull could take a meeting of key Permanent Secretaries plus Peter Gershon to satisfy himself that the Treasury and DWP are handling the issue sensibly.

9.

JEREMY HEYWOOD

conqueror

To:
Secretary of State

From:
Rupert Huxter
Postal Services
Rm 412, BPR
Tel: 020 7215 4115
Fax: 020 7215 1642

Date: 2 October 2002

cc:
Mr Timms
PS/Sir Robin Young
Mark Gibson
Mark Higson BRPS
Haf Merrifield BRPS
Mark Smith Legal
Mike Snowdon NEWS
Geoffrey Norris No 10
Special Advisers

ROYAL MAIL: POSTCOMM PRICE CONTROL PROPOSALS

Issue

1. Publication of Postcomm's Consultation Document; intemperate Royal Mail press notice.

Recommendation

2. Agree attached line to take.

Timing

3. **Immediate** - Postcomm intend to publish on 3 October and both Company and Regulator are likely shortly to start briefing the press for tomorrow.

Background

4. Mark Higson's parallel submission of today's date gives an update on the continuing dispute between Royal Mail and Postcomm. The Company have sent us a copy of their proposed PN (attached), which is outspoken in its criticism of Postcomm, calling the proposals "shocking" and "regulation gone mad". We have spoken to the Company to urge a more constructive and less polemical line, but the language used is explicitly endorsed by Allan Leighton and any changes are likely to be minor.

5. The proposed line to take in the face of the public row that now looks set to ensue is attached. Our aim must be to acknowledge the real differences between the two sides, while urging them to use the consultation period to get together and resolve them.

Rupert Huxter

POSTCOMM PRICE CONTROL CONSULTATION DOCUMENT: LINE TO TAKE

- Disappointed that Postcomm and Consignia have not yet been able to reach agreement on the right means of meeting the commercial needs of the Company while ensuring a good deal for customers.

- See tensions of this kind as normal and entirely to be expected within a robust regulatory regime.

- The questions are for the parties themselves to sort out. The important thing now is for the Company and the Regulator to get together urgently and use the consultation period to find a mutually acceptable way forward.

Embargoed: Not for use before 0001, October 3, 2002

DS 159
October 3, 2002

POSTCOMM PLANS ARE "REGULATION GONE MAD," SAYS ALLAN LEIGHTON

Royal Mail said today the price controls Postcomm wanted to impose would choke the company and ruin any prospect of putting the UK postal service on a secure commercial footing.

Allan Leighton, Chairman, said: "These are shocking proposals. The regulator is trying to put us in a straightjacket.

"All we asked for was a modest 1p rise in basic postage prices as part of a balanced recovery plan for a business that's losing £1.2 million a day. Six months after making the request, we're being offered a heavy-handed set of price controls which strip out £460 million of revenue – more than cancelling any benefit Royal Mail gets from a small rise in prices.

"The regulator is giving with one hand and grabbing even more back with the other. This is regulation gone mad."

Mr Leighton said the proposals were unacceptable. "We have repeatedly proposed alternatives that would still produce a stretching and challenging pricing regime, far tougher than any control regime facing rival operators.

more follows/…

"Postcomm has rejected our constructive proposals and proceeded to publish a set of controls which - they know - will remove our ability to borrow against our reserves to raise the funding for our renewal plan. That will fatally damage our chances of recovery.

"Postcomm's plans will destroy the one-price-goes-anywhere universal service which only Royal Mail provides. Incredibly, this is the very thing that Postcomm is charged to protect above anything else. Postcomm is behaving recklessly with the interests of customers.

"If the regulator doesn't loosen the grip it wants over us, we will have no option but to set in motion a process which will lead to the proposals being referred to the Competition Commission," said Mr Leighton.

He added: "Once again the regulator is attempting to push the boundaries of regulation far beyond what is accepted in other countries. Postcomm has already given a green light to the German and Dutch post offices to deliver domestic mail in the UK, yet much of the German and Dutch domestic mail markets remain closed to competition."

The proposal Royal Mail put to the regulator was for a 1p/1p increase on basic First and second class postages prices, with rises at the same scale for heavier letters and packets. Under Postcomm's proposals, the penny increases have been allowed.

But Postcomm also wants to impose a rigid formula, which would fix the weighted average of the price of a wide range of products and services at 29.1p.

"This constraint has a dire effect on Royal Mail," said Mr Leighton. "If, as seems likely, rivals can win low-price mail from us, then the weighted average price of our products and services rises. That would breach Postcomm's average price formula so to comply with it, we would have to cut some of our prices.

"It's a double whammy. Not only does Royal Mail lose out if rivals can take our business. We also suffer from being forced to lower prices and our revenue falls further.

more follows/…

"Perversely, Postcomm's formula would also penalise us if we won new, higher-priced business, such as Royal Mail's Special Delivery guaranteed service, which, at a basic price of £3.65, is competing strongly against rivals. Every time we carry an extra Special Delivery item, the weighted average price of all our services rises – and to comply with Postcomm's formula, we would have to lower prices.

"It means that winning Special Delivery business costing customers £3.65 generates just 29p for Royal Mail. Where's the commercial incentive for Royal Mail behind that sort of barmy regulation?" said Mr Leighton.

The overall effect of the regulator's average price formula is to strip out £300 million of revenue over the three years of the price control.

A further £130 million of revenue will be lost as a consequence of Postcomm's intention to include in the price control a raft of products and services outside the £1 domestic mail, licensed area. These products include airmail and First and Second class letters and packets costing more than £1.

If Royal Mail raised some of the prices for these items, it would have to make corresponding price decreases elsewhere. Meanwhile, the 4,000 rival courier and parcel companies already operating in this sector can continue to charge any price they want, as long as it is more than £1.

Mr Leighton added that although Postcomm had referred repeatedly to a price freeze after allowing basic First and Second class prices to rise by 1p from next April, the impact of the regulator's RPI minus 2.5% rule, a percentage higher than expected rates of inflation would deliver a real decrease overall in prices over the three years of the price control, costing Royal Mail a further £30 million.

"The recovery plan is the toughest task the company has ever faced. We've always accepted that our prices should be subject to regulatory control but just when we need a degree of flexibility, we're being invited to put ourselves in an arm lock," said Mr Leighton.

more follows/…

In contrast, he broadly welcomed a proposed new, improved compensation scheme for Royal Mail customers, detailed by Postcomm.

"It's right that in return for a modest price increase, Royal Mail should be assuring customers that when standards fall below targets, there is both accountability and recompense," said Mr Leighton.

"It's also right that the regulator's proposals should provide incentives for improved performance – something Postcomm's thinking on pricing fails to do."

Mr Leighton added that Royal Mail would respond formally in coming weeks to Postcomm. "But we would be like turkeys voting for Christmas if we accepted the pricing package," he said.

- Ends -

Issued by Group Communications: 020 7250 2468 (24 hours)
Room 108
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(*www.consignia.com*)

Notes to Editors

1. Royal Mail postage prices are among the lowest in Europe and customers have benefited from the most stable prices in more than half a century. There has only been one increase in basic First Class prices in the last six years, from 26p to 27p in April 2000. The basic Second Class price of 19p is 1p lower than six years ago, and Second Class services currently lost £172 million last year. If First and Second class prices had risen by inflation over the last six years, then, all other things being equal, there would be an additional £500 million in revenue a year.

more follows/…

2. Royal Mail is currently barely breaking even providing the one-price-goes-anywhere universal service to the UK's 27 million addresses. The regulatory accounts recently sent to Postcomm disprove any notion that the universal service is a money-spinner for Royal Mail. Last year, Royal Mail made an operating profit of just £9 million on the universal service. This year, it is heading into heavy loss.

3. Even competitors have questioned the pace at which Postcomm is opening the UK mail market. From January, a third of the mail market by value will be open to competitors, with the market fully opened from April 2007. In May this year, Peter Bakker, chairman of TPG, the Dutch postal group, said Postcomm's plans were "too aggressive."

4. Since January this year, there has been rises in the cost of basic postage in Denmark, Greece, Ireland, Portugal, Spain and Sweden.

To Secretary of State

From Mark Higson
Director, Postal Services
Rm 412 BPR
Tel: 020 7215 4115
Fax: 020 7215 1642

ci Mr Timms
PS/Sir Robin Young
Mark Gibson
Hâf Merrifield, BRPS
Rupert Huxter, BPRS
Mark Smith, Legal
Mike Snowdon, NEWs
Geoffrey Norris, No 10
Special Advisers

2 October 2002

ROYAL MAIL: INSOLVENCY AND DISPUTE WITH POSTCOMM

Issue

1. The continuing dispute between Royal Mail and Postcomm, and the risks this now poses for the solvency of the company. What are our options, and how should we be taking the issue forward? We need to tread a careful path to avoid both undermining the company's negotiating position, and taking undue risks that the company may become insolvent. On presentation, we need to position ourselves carefully in what will be a public and increasingly acrimonious row. Rupert Huxter's note reports on Allan Leighton's opening salvo.

Recommendation

2. Primarily for note at this point, but we believe that, despite the postures being struck, we should be steering the parties to an accommodation along the following lines:

(i) for rapid progress to be made by Postcomm in their discussions with Consignia so that Postcomm is able to strengthen their statement in the Graham Corbett's letter that the aims of the proposed control (best possible deal for customers while ensuring the funding which is required to deliver the renewal plan) are agreed, and that it is the means which are being consulted on. In particular we need some recognition that the impact of the pricing formula needs to be robust enough to ensure that financing can work on the company's own figures, not just Postcomm's more optimistic figures. The simple 1p price increase would do this, but there are other ways which we have suggested, which can meet Postcomm's desire for pricing flexibility. A statement by Postcomm on these lines would have been better made in the consultation document, but could be made separately assuming Postcomm publish later this week.

(ii) For the Board to accept that if there is quick movement by Postcomm, then the better course is to continue negotiations, not reach a conclusion that the company cannot go forward and is therefore insolvent.

(iii) For the DTI as shareholder to put in place revised temporary financing arrangements which would run for the 2-months' consultation. Current arrangements were designed in the early summer to bridge the gap to an early August consultation whose terms were expected to be acceptable to the company. New arrangements would have to be on a commercial basis if they are to be in accordance with the Market Economic Investor Principle and thus not be a state aid. This will need some comfort that ultimately the renewal plan can be financed, and Postcomm's position will be key to that. We may also have to consider giving the Board comfort on insolvency, as we did in May and early summer when insolvency was last to the fore.

3. On process, we will feed in the messages at official level, but we will need you to help press the parties together, both in your contacts with Allan Leighton, and at your meeting with Graham Corbett next Monday.

4. On presentation, we believe that we should stand back and say that it is a matter for the parties to sort out during the consultation. We might indicate that rows of this kind are inevitable and even proper under the regulatory regime, and that we are confident that an appropriate accommodation can be reached. This may be increasingly difficult to sustain if the company seeks to undermine public confidence in the regime and/or the company is seen to be on the point of insolvency. See Rupert Huxter's separate note on Consignia's proposed press release and lines to take.

Timing

5. Urgent: the situation is fast moving.

Background

The options

6. We have identified the following as options open to Consignia:

(i) put aside the consideration of the going concern issue while an emergency price application is made under condition 19 of the licence (but Postcomm would seem unlikely to agree a price increase if they can't agree to change the consultation document so Consignia's recourse would then be to judicial review)

(ii) declare the company insolvent (but what is the next step after that?)

(iii) live without a price rise for 18 months (and no change on standards of service) and get a hearing before the Competition Commission (this course may be that such a financiable by HMG, but with a larger financing envelope to cover the loss of revenue - hence less attractive return and potential difficulties about justifying the state aid position).

(iv) keep going for two months plus in the expectation of the consultation producing the right answer. If it did not, then if insolvency were looming at that point, HMG would be in an immeasurably better position to intervene if representations had been made and rejected. And with the disapplication request ticking away, we could expect Postwatch to be increasingly concerned with the standards of service which need your agreement to implement, and would support during the consultation process.

7. The Company's strategy has been to use the imminence of insolvency to put pressure on Postcomm to give greater comfort. This is fine, but Postcomm have shown a resilience to pressure of this kind and may well not believe that the Government would allow Consignia to go into administration. The company's position does not appear to have been thought through beyond this point. Actually declaring the company insolvent would be a major step and it is hard to see how it could be a rational act if consultations were still in progress and if HMG were prepared to finance in the meantime.

8. This is why we are keen to see negotiations kept going during the consultation. (Despite the vehemence of Allan Leighton's public reaction, the press notice envisages continuing representations.) If at the end of the consultation, Postcomm still refused to propose a pricing formula which would enable Consignia to be financed on a commercial basis, then the position would be very serious indeed. It is hard to see how such a course of action could be consistent with their duties. If nonetheless we got to this position, I believe we would have to accept that the model of commercial operation under regulation in the public sector had failed. Our main options would then be

(i) Rescue aid and an approach to Brussels to agree a rescue plan for the mails business. This would basically mean that the mails restructuring were being subsidised by Government, and we would probably have to introduce legislation in due course to prevent this happening again.

(ii) If Consignia were on the point of insolvency, and the uso placed in jeopardy, we would have to consider using our powers under section 102 of the Postal Services Act to modify Postcomm's functions. Legal advice is that this is not straightforward.

(iii) Allow Consignia to go into insolvency, with the expectation that the administrator would find a buyer for the business (eg TPG).

None of these are attractive, but it is hard to see why we would ever get to the position where we had no other choice. However, their existence and the possibility of their being used as a threat might help ensure that more sensible outcomes prevail.

10. Consignia has now given 18 months notice of termination of the current price control. This puts some discipline on Postcomm in that if agreement cannot be reached, then the price control falls away completely in 18 months, and would require a reference to the Competition Commission before anything can be put in its place. It would be reasonable to assume that the Competition Commission might be inclined to place more weight on the need for a licensee to be able to finance activities on a commercial basis.

Comment

11. This is a very tricky issue for the company. Basically they have lost patience with the continual shifting of position of Postcomm. Martin Stanley has been giving signals that the result of the consultation will be more favourable to Consignia, but wants to have an open consultation. However, previous signals to this effect, including Graham Corbett's letter to the Secretary of State, have so far not been given concrete effect.

12. PostWatch are happy with the straight 1p price rise proposed by Consignia and cannot understand why Postcomm are trying to claw back some of the revenue.

13. My own view is that it is very likely that Postcomm will concede enough in the consultation to enable Consignia to be financed on a commercial basis. And if they did not, then we would be in a much stronger position if our representations had been ignored to take action if Consignia was facing insolvency, than if we were seeming to argue about what should be in a consultation document. Allan Leighton and Marisa Cassoni are less charitable and feel that Postcomm are simply stringing them along.

Mark Higson

RESTRICTED - POLICY

From:
Helen Fleming
Economic & Domestic Secretariat

PRIME MINISTER

Copies:
Sir Andrew Turnbull
Paul Britton EDS
Jaee Samant EDS
Jeremy Heywood
Geoffrey Norris
William Perrin
Oly Jones

PM

My instinct is that we are heading for trouble & pitchfork chaos on this. I think this advice is right. AT should also involve himself. GS

27 September, 2002

UNIVERSAL BANK (UB)

Andrew Smith has sent an update note. The project is proceeding to plan but all of the most difficult elements still need to be put in place within an extremely tight timetable. OGC has just reviewed the project and rated it high risk (Red status).

Privately, OGC say that the best course of action would be to delay plans to use UB until the service delivered by the Post Office can be thoroughly tested (i.e. several months after April 2003). Given the sensitivity of this course of action, the OGC has not recommended an immediate review but said that one should take place before the end of the year.

Instead it has focused on the need to reduce payment volumes on Day 1 so as to minimise the risk of serious failure. The obvious way to achieve this is to get Inland Revenue to pay New Tax Credits via giro until UB is known to be running properly. Their payments make up the vast majority of the load on Day 1 at present. But Treasury Ministers are resisting this strongly as they had to fight hard in Parliament to make payments via bank accounts compulsory. Andrew Smith has spoken privately to the Chancellor to express his concern at the political fall-out from a failed launch of UB next spring. We do not know the Chancellor's reaction.

The other main recommendations were:

- To improve the quality of the pilot scheme, and allow more time for lessons to be learned from it;

- To put in place arrangements for managing the numbers of Card Accounts and BBAs after April next year.

OGC also commented on the importance of the sub-postmasters in making UB a success. They currently have major concerns about the impact of UB on their business and Andrew Smith reports relations as being "very fragile".

MISC19, under Andrew Smith's chairmanship, is scheduled to look at all of the recommendations in October. Handling of UB is now becoming critical as the visibility of the project will grow, in particular with the first approaches to Child Benefit recipients planned for late October.

Do you want to reply saying that we must act on the OGC recommendations in order to improve the chances of success; but, in addition, asking Andrew Smith to report back urgently on:

- **The case for delaying the operation of UB to make payments to New Tax Credits and benefit customers, given the serious concern expressed by OGC; and**
- **Plans for handling stakeholders, especially the National Federation of Sub-Postmasters, in the event that UB has to be delayed.**

I agree. Get AT to look at this urgently. We really need to watch this + HMT + AG in WSP needs to be reunited with my concerns

Helen Fleming

f.o.

GD

cc: JJH
OJ
DS

RESTRICTED – POLICY

Prime Minister

UNIVERSAL BANKING UPDATE

Summary

The recent Office of Government Commerce (OCG) review has highlighted the great strides taken in the last six months to put the universal banking programme on a sound footing. But the report still assesses the Project as "RED" meaning we need to take remedial action now and I am talking to Ministers about the steps we need to take. We will also, by December, have received enough information to make a final assessment about the feasibility of the April go-live for the Universal Bank. The timetable remains tight and the risks are great. The banks have still not all signed contracts, but we are very close now.

1. This is a further update on universal banking, following my last minute of 30 July. At that time, the banks were seen as the biggest obstacle to progress and the biggest area of risk. They have continued to cause problems. When the issue raised by HBOS was resolved, another arose with the banks that have subsidiaries in Northern Ireland. Now that has been sorted out, the Nationwide Building Society has raised an issue over testing. Despite that, several banks have now signed contracts with

the Post Office, and others are in the process of doing so. I no longer see this as a likely showstopper.

2. Relations with the National Federation of Sub-Postmasters are very fragile, across the whole range of their activities, not just universal banking. Patricia Hewitt had a difficult meeting with their Executive on Monday. This is not a helpful background against which to bring in universal banking, and we have seen some instances of sub-postmasters taking unauthorised action to try and secure customers for the card account (Post Office management are dealing with this).

3. During August, Inland Revenue started its planned invitation process for existing tax credit customers, and the Post Office started installation of PIN-pads on counters. Both exercises are going well. The Veterans' Agency will start writing to its customers in early October, and DWP will contact the first wave of child benefit customers towards the end of October. In both cases the material going out has been subject to consultation with a wide range of stakeholder groups, and while not all are completely happy, there should be no surprises.

4. The OGC have just completed their second review of the Programme: Their main findings are:

- Great strides have been made in taking universal banking forward since their first review in February.

- There can now be greater confidence that the delivery of the Government's commitment (that, as the paying departments move to ACT, cash will continue to be available over the counter at post offices) is capable of being achieved.

5. However, they also say:

- Only six months remain until the planned start of implementation and migration from April 2003, and there is a great deal still to be achieved in a highly compressed timetable.

- Go-live in April is achievable only if everything goes exactly as planned between now and then – which rarely happens in programmes

- Decisions on key steps will have to be taken on incomplete information.

- The time for testing and overall assurance activities is extremely short so, even if delivery is achieved in April, there is a risk that the new services will not work as well as we want in the early days.

- The Inland Revenue's plan to take on a large volume of payment cards from day 1 (currently estimated at around 300,000 cases) – a classic big-bang approach - is very high risk and should be reconsidered now

- Given the operational issues facing the Inland Revenue Dawn Primarolo should be invited to join MISC 19

Overall, they still rate the programme as being at high risk and rated as "RED" – requiring remedial action now.

6. The issues raised by the OGC team are ones we were already considering as a matter of urgency in the Ministerial Committee on universal banking. Between now and Christmas we face some very

difficult decisions about whether to go fully "live" in April, with large numbers of customers from Day 1 or, as OGC advise, to go for a more cautious build up. This is a particularly sensitive issue for Inland Revenue who, on current plans, will have nearly 300,000 customers needing to use the card account in the first month. I am, as a matter of urgency, consulting Ministers individually about the way forward.

7. I will keep you informed of developments and report back in December. I have scheduled a meeting of MISC19 in early December to help form a judgement on the planned go-live in April based on the evidence we then have before us, but I wanted to begin to alert you to the issues now.

8. I am copying this minute to Gordon Brown, Patricia Hewitt, Paul Boateng, Stephen Timms, Douglas Alexander, Dawn Primarolo, Lewis Moonie and to Sir Andrew Turnbull and Peter Gershon.

pp AS
27 September 2002
(Agreed by the Secretary of State and signed in his absence)

RESTRICTED – POLICY

Prime Minister

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pp **AS**
27 September 2002
(Agreed by the Secretary of State and signed in his absence)

Stephen Timms MP
Minister for E-Commerce and Competitiveness

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The Rt Hon John Prescott MP
Deputy Prime Minister
Office of the Deputy Prime Minister
Dover House
Whitehall
London, SW1A 2AU

21 August 2002

DJ
JJH.
UP

Dear John,

It was recognised at the DA Committee meeting on the post office network on 9 July that, when a negative decision on national roll out of the *Your Guide* programme is announced, it would be advantageous for Government and the Post Office to be able to announce examples of new government information and services to be offered through post offices as a positive spin off from the pilot project. This will require urgent co-operation between key Government Departments and the Post Office over the next month and a half. The purpose of this letter is to seek your agreement to the necessary action.

It was agreed at the DA Committee meeting on 9 July that, although the *Your Guide* evaluation report should be published at an early opportunity, in part to help manage expectations, the decision on the future of the *Your Guide* programme should not be announced until after the Summer Recess and that, in the meantime, the Post Office should explore possible commercial alternatives. This they are doing with the support of my department and the e Envoy's Office.

DA committee members also recognised that when the negative decision is announced, there would be considerable advantage at the time the announcement was made in being able to point to specific examples of new business opportunities involving government departments which had arisen directly or indirectly as a result of the *Your Guide* pilot. There is general expectation that Government will announce its final decision on the future of *Your Guide* in October and this would fit with timing on other post office network announcements. Clearly it would not be sensible within the timescales involved to attempt to pursue a large number of options and officials in my department have therefore asked the Post Office, on the one hand, and DWP and Inland Revenue (as key service-providers during the pilot), on the other, to identify priorities.

The Post Office believe that their potential strengths lie in filtering or prequalifying applications in the areas of Minimum Income Guarantee, Income Support/Jobseekers Allowance and the tax and pension credit schemes and in reducing fraud through validation and identification of applicants. However it is ultimately for Departments to determine which of their services they would wish to make available through post offices.

The Rt Hon John Prescott MP

It will be important to explore potential options with a degree of urgency to ensure that by early October we have a reasonable understanding of what is feasible and hence of the likely shape of the overall network package to be announced. My purpose in writing is to seek your agreement that officials in your Department will engage with the Post Office team as a matter of urgency to take this work forward.

I am copying this letter to the Prime Minister, the Paymaster General, other members of DA Committee and to the Secretary of the Cabinet.

Yours ever,

Stephen

STEPHEN TIMMS

From: Geoffrey Norris
Helen Fleming
Date: 31 July 2002

PRIME MINISTER

cc: Jonathan Powell
Jeremy Heywood
Alastair Campbell
Sally Morgan
Robert Hill
William Perrin

UNIVERSAL BANK

Attached an update note from Andrew. UB will become increasingly publicly visible in the coming months, but the project is still touch and go.

HBOS – the Halifax and Bank of Scotland- (where Denis Stevenson is chairman) is still dragging its feet on signing up and is seriously threatening to derail the timetable for launch next April. And if they refuse to sign up, the other banks will not either, so the whole project would fall.

And there are big IT risks. Peter Gershon assesses UB as one of the riskiest IT projects currently underway. The biggest risk he has identified is that the system will not be able to cope with the size of the Day 1 workload - the current plan is that all the New Tax credit payments will enter the system at once. Ministers have considered the possibility of delaying by three months NTC payments, but HMT and Inland Revenue are strongly resistant. **Do you want to reply to Andrew saying you would like a further investigation of what could be done to mitigate the danger of Day 1 overload?**

Yes. This is going to be tough
I will want updates.

GEOFFREY NORRIS

RESTRICTED - POLICY

Prime Minister

UNIVERSAL BANKING - UPDATE

Summary

Progress continues to be made on this challenging project. But the risks still remain. It is a politically contentious proposal which is being delivered to some very tight timescales and with considerable financial risks. The latest milestone - the signing of contracts between the Post Office and the UK clearing banks - is being held-up by Halifax Bank of Scotland (HBOS). We are working hard to persuade HBOS to sign but there remains a risk that agreement can not be reached and that the project will have to be delayed. Detailed project planning is continuing and will become increasingly visible to the public in the Autumn.

1. I thought you might find it helpful to have a report ahead of the summer break on progress towards implementation of universal banking services at post offices from April 2003.

2. In many respects, good progress is being made. On 17 July I held a special meeting of the Ministerial Committee on Universal Banking at

which all those involved in contributing to this complex programme - the Post Office, and representatives of the banks, as well as Inland Revenue and DWP - set out their plans. This brought out some common ground. It is clear that the Government Departments involved, the Post Office, and indeed the British Bankers' Association, are now working very effectively together – an achievement in itself. But there are still major risks to successful delivery next April.

3. Some important steps on the way have now been successfully completed:

- Contracts are in place between the paying Departments and the Post Office and between Post Office and its suppliers, for the Card Account at Post Office Service.

- A detailed set of key messages have been agreed between all the programmes. Leaflets, call-centre scripts and staff training material will be developed from these. The important thing is that customers should get consistent messages whether they contact the social security office, telephone a call centre or speak to their local subpostmaster.

- DWP has appointed a marketing company and is working with them to develop a fully effective information campaign. DWP is also working with its preferred supplier to put in place the "Customer Conversion Centre" by October.

- The universal banking team is getting most (though not yet all) key stakeholder groups to understand and accept the Government's policy towards modernising the way benefits and tax credits are paid.

- Even the National Federation of Subpostmasters are not as hostile as they were, although their members are still very concerned about their future. The NFSP has dropped its unrealistic aim of getting up to 16 million Card Account customers. But it still has a fundamental difference of view with the Government and will continue to campaign for "free choice" in the way banking options are presented to customers.

4. The most critical risk remains that - 15 months after Stephen Byers negotiated the Memorandum of Understanding - the banks have still not signed contracts with the Post Office setting out the detailed basis on which their basic accounts will be accessed at post offices.

5. This is now seriously jeopardising the April 2003 start date. The position for some weeks now has been that all the banks have been ready to sign, except one (Halifax Bank of Scotland) which has taken an excessively legalistic stance, and is holding up signing by all the others. All involved have bent over backwards to accommodate HBOS' concerns; and both Paul Boateng and I have intervened personally with the chairman, Lord Stevenson. The OFT have now been consulted under their informal procedure and they provided some reassurance.

6. However, HBOS are still considering their position, and may insist on a formal reference to the OFT. This in turn could jeopardise the whole timetable (since formal references in the past have taken well over a year to complete). So a further Ministerial intervention may well be needed in the next few days, should HBOS decline to accept the assurances which have been offered. There is also a risk that the other banks would object to what they would see as an unnecessary referral to OFT.

7. Otherwise, delivery remains on track, but the OGC and others who have looked at the plans are concerned by the scale and complexity of what we are trying to do, and the very limited timescale for doing it. We are therefore looking at ways of reducing risk and ensuring a smooth start, as well as contingency plans if the banks were to walk away, or if the Post Office hit problems in putting all the changes in place in time. Ideally, we would thoroughly test all the technology and business processes through a full-scale pilot before going live, but there is time only for a very limited pilot. One area of uncertainty is how customers will react when contacted, and what their experience will be when, for example, they try to open basic bank accounts.

8. From August the programme will become increasingly real and visible to the public: the first visible signs of this major set of changes will appear over the summer, which is one reason why I wanted to update you now:

- Beginning now, PIN-pads will start appearing on the customer side of post office counters; nearly 40,000 pads will be installed by April (a major logistical exercise in itself).

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- The Veterans Agency will start contacting its customers - a relatively small number of war pensioners - from 7 October.

- DWP now plan to start their process of converting customers from order book to payment into bank accounts in a very low-key way, building in time to learn from experience and if necessary make changes to plans. We will write to around 120,000 child benefit customers in the week of 21 October, inviting them to supply bank details for use from next April. We will not contact any further customers for at least six weeks after that while evaluating the reaction of the first group.

9. We will keep our communications low key over the summer but will of course ensure that Ministers and Press Offices are fully briefed so as to be able to deal with any issues which arise.

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AS
30 July 2002

Received already by fax KH

RESTRICTED – POLICY

Prime Minister

UNIVERSAL BANKING – UPDATE

Summary

Progress continues to be made on this challenging project. But the risks still remain. It is a politically contentious proposal which is being delivered to some very tight timescales and with considerable financial risks. The latest milestone – the signing of contracts between the Post Office and the UK clearing banks - is being held-up by Halifax Bank of Scotland (HBOS). We are working hard to persuade HBOS to sign but there remains a risk that agreement can not be reached and that the project will have to be delayed. Detailed project planning is continuing and will become increasingly visible to the public in the Autumn.

1. I thought you might find it helpful to have a report ahead of the summer break on progress towards implementation of universal banking services at post offices from April 2003.

2. In many respects, good progress is being made. On 17 July I held a special meeting of the Ministerial Committee on Universal Banking at

which all those involved in contributing to this complex programme - the Post Office, and representatives of the banks, as well as Inland Revenue and DWP - set out their plans. This brought out some common ground. It is clear that the Government Departments involved, the Post Office, and indeed the British Bankers' Association, are now working very effectively together – an achievement in itself. But there are still major risks to successful delivery next April.

3. Some important steps on the way have now been successfully completed:

- Contracts are in place between the paying Departments and the Post Office and between Post Office and its suppliers, for the Card Account at Post Office Service.

- A detailed set of key messages have been agreed between all the programmes. Leaflets, call-centre scripts and staff training material will be developed from these. The important thing is that customers should get consistent messages whether they contact the social security office, telephone a call centre or speak to their local subpostmaster.

- DWP has appointed a marketing company and is working with them to develop a fully effective information campaign. DWP is also working with its preferred supplier to put in place the "Customer Conversion Centre" by October.

- The universal banking team is getting most (though not yet all) key stakeholder groups to understand and accept the Government's policy towards modernising the way benefits and tax credits are paid.

- Even the National Federation of Subpostmasters are not as hostile as they were, although their members are still very concerned about their future. The NFSP has dropped its unrealistic aim of getting up to 16 million Card Account customers. But it still has a fundamental difference of view with the Government and will continue to campaign for "free choice" in the way banking options are presented to customers.

4. The most critical risk remains that - 15 months after Stephen Byers negotiated the Memorandum of Understanding - the banks have still not signed contracts with the Post Office setting out the detailed basis on which their basic accounts will be accessed at post offices.

5. This is now seriously jeopardising the April 2003 start date. The position for some weeks now has been that all the banks have been ready to sign, except one (Halifax Bank of Scotland) which has taken an excessively legalistic stance, and is holding up signing by all the others. All involved have bent over backwards to accommodate HBOS' concerns; and both Paul Boateng and I have intervened personally with the chairman, Lord Stevenson. The OFT have now been consulted under their informal procedure and they provided some reassurance.

6. However, HBOS are still considering their position, and may insist on a formal reference to the OFT. This in turn could jeopardise the whole timetable (since formal references in the past have taken well over a year to complete). So a further Ministerial intervention may well be needed in the next few days, should HBOS decline to accept the assurances which have been offered. There is also a risk that the other banks would object to what they would see as an unnecessary referral to OFT.

7. Otherwise, delivery remains on track, but the OGC and others who have looked at the plans are concerned by the scale and complexity of what we are trying to do, and the very limited timescale for doing it. We are therefore looking at ways of reducing risk and ensuring a smooth start, as well as contingency plans if the banks were to walk away, or if the Post Office hit problems in putting all the changes in place in time. Ideally, we would thoroughly test all the technology and business processes through a full-scale pilot before going live, but there is time only for a very limited pilot. One area of uncertainty is how customers will react when contacted, and what their experience will be when, for example, they try to open basic bank accounts.

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