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Trade and Industry Committee

Royal Mail Group

Ninth Report of Session 2005–06

Report, together with formal minutes

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The Trade and Industry Committee

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Footnotes

In the footnotes of this Report, references to oral evidence are indicated by 'Q' followed by the question number. References to written evidence are indicated in the form 'Appendix' followed by the Appendix number.

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Summary

Historically the UK has enjoyed the benefits of a comprehensive network of sub-Post Offices, often in very remote, rural locations, because of the wide range of services the Government chose to put through those Post Offices. On top of unavoidable technological and social change which have reduced client footfall, the Government is now withdrawing services from Post Offices.

In January 2006, it became apparent that the Department for Work and Pensions (DWP) would not be renewing its contract with Post Office Ltd for the Post Office card account (POCA) after the end of the current contract. Most of the DWP's partners in the POCA assumed that the contract would be renegotiated after 2010. This has, quite understandably, led to a lot of bad feelings amongst these partners and a sense of betrayal amongst sub-postmasters. We do not believe that the Government made it clear enough that there would be no possibility that the contract would be renewed. However, we note that the Minister has suggested there may be a substitute for the POCA. We would welcome early clarification as to what this would be.

The ending of the POCA shows a lack of joined-up thinking between Government departments with regards to the Post Office network. The DWP is undermining the network by removing the POCA. Though the most serious, this is not the only blow, as decisions by the BBC and the DVLA (with respect to licensing) have also removed income from Post Offices. The perceived financial benefit for the taxpayer is questionable. These revenues for Post Office branches may still have to be found from the public purse in the form of increased subsidy payments to keep the network afloat.

We are seriously concerned about the apparent lack of urgency in the remit given to the Cabinet sub-committee examining the future of the Post Office network. Sub-Post Offices have already lost sources of income, and postmasters will be making decisions now on whether they can sustain their business. Decisions are needed by the Government now to plan the Post Office network for the future, taking into account postal services and the wider social functions provided by Post Offices in local communities. If the Government fails to act, the network and all the benefits it provides for communities could be lost forever.

We were encouraged to see that the Government is prepared to support the Royal Mail Group financially within the proposed new financial framework. We would expect this of any responsible shareholder in a company needing significant investment to enable its business to flourish. However, we were surprised to hear that Royal Mail Group had placed conditions on agreeing to the Government's proposals. We understand that the management believes the revitalisation of Royal Mail is possible only if the workforce is given the incentives to deliver the desired growth in productivity. However, the Royal Mail Group managers' insistence that they would not accept the new financing framework unless their proposed share scheme was agreed by the Government is perverse given the company's obvious need for the finance and especially so since we have grave doubts whether the proposed share scheme would provide sufficient or appropriate incentives.

1 Introduction

General Background

1. The 1999 White Paper *Post Office Reform: A World Class Service for the 21st Century* set out the Government's policy for the reform of the postal services market in the UK.¹ The UK is bound by EU law on postal matters. In the UK, the *Postal Services Act 2000* gives effect to the requirements of the EU 1997 *Postal Services Directive*² (subsequently amended in 2002³), including the requirement to maintain an universal service.

2. Following postal services market liberalisation in the UK, the 2006-2010 agreement on price controls between the Postal Services Commission (Postcomm) and Royal Mail Group, and an announcement from the Government that it was prepared to assist Royal Mail Group financially, we decided to hold a brief follow-up to our previous inquiries into the Royal Mail Group. The issues we were interested in finding out about were areas where discussions between the Royal Mail Group and the Government are continuing, specifically: the extent to which the refinancing package, announced by the Government, will help Royal Mail to pay for modernisation and deal with its pension fund deficit; the structure of the 'shares' scheme proposed by Royal Mail Group's managers; and the future of the Post Office Card Account ('POCA') and the impact its demise will have on the Post Office network.

3. We last looked at the postal services market at the end of 2005 in the lead up to the full liberalisation of the market in the UK.⁴ It was during this inquiry that many of our witnesses suggested that the Royal Mail Group would become uncompetitive, given that there had been large scale capital underinvestment in the past and a large deficit in its pension fund had developed. Witnesses also drew our attention to the question of the future ownership of Royal Mail Group, particularly a proposed employee share scheme. Our predecessors looked at the POCA as part of their inquiry into the implementation of Direct Payment.⁵ Our predecessors were led to believe that the POCA would replace the Government business that would be lost through a change in benefit payments arrangements. There was no suggestion then that it would be temporary.⁶

4. In the course of our inquiry we took oral evidence from representatives of the Royal Mail Group, the Communication Workers Union (CWU) and the National Federation of SubPostmasters (NFSP), as well as from Jim Fitzpatrick MP, Parliamentary Under Secretary of State for Employment Relations and Postal Services at the DTI. We also received seven written memoranda from other companies, trade associations and

1 Cm 4340

2 European Commission Directive 97/67/EC

3 European Commission Directive 2002/39/EC

4 Trade and Industry Committee, *Royal Mail after Liberalisation*, Second Report of Session 2005-06, HC 570 I & II (hereafter, *Royal Mail after liberalisation*)

5 Trade and Industry Committee, *People, Pensions and Post Offices: The impact of 'Direct Payment' on Post Offices and their customers*, Eleventh Report of Session 2002-03, HC 718

6 Q 165

interested bodies, which are listed on page 37. We express our gratitude to them and to all who contributed to our inquiry.

2 A new financial framework

Capital investment for modernisation

5. During our inquiry into the *Royal Mail after Liberalisation*, almost all of our witnesses agreed that Royal Mail’s infrastructure required capital investment because of years of underinvestment.⁷ Royal Mail Group told us that it needed this capital investment to enable it to compete with other postal operators in the newly liberalised market, which had “huge advantages because the modernisation that we are talking about embarking on they did without any competition and over a 10–15 year period. So they have already done what we have not even started”.⁸ As an example of this, Royal Mail Group told us that almost all of its sorting equipment was obsolete and required replacement, having been designed and installed in the early 1990s. Royal Mail sorted around 50 percent of its letters mechanically compared to more than 90 percent for competitors such as TNT and Deutsche Post,⁹ a situation Royal Mail Group described as “not sustainable”.¹⁰

The Royal Mail Pension Plan

6. The Royal Mail Pension Plan (RMPP) was created when two previous schemes—the Post Office Staff Superannuation Scheme (POSSS) and Post Office Pension Scheme (POPS)—were merged. The RMPP scheme moved into deficit at March 2000 and annual deficit payments of around £50 million started in March 2001.¹¹ At March 2005 the RMPP was 88.7 percent funded and £2.2 billion in deficit. A more detailed breakdown of the pension fund deficit/surplus since 1988 is given in the table below.

7. The evidence Royal Mail Group presented to us during our previous inquiry suggested that the pension fund deficit at March 2003 was actually £4.0 billion and not £2.5 billion.¹² This discrepancy, it told us, was due to changes in the accounting methodology used to calculate its pension liabilities on its balance sheet.¹³ Under this definition, the pension fund deficit has since risen from £4.0 billion as at 31 March 2003 to £5.6 billion at 31 March 2006.¹⁴ Royal Mail Group told us that, due to the pension fund deficit, it had a £2.0 billion balance sheet liability,¹⁵ which had left the business technically insolvent and therefore unable to raise private sector capital.¹⁶

7 For example see *Royal Mail after Liberalisation*, Volume II, Appendix 4, para 26 and 43; and Royal Mail, *Response to Postcomm’s initial proposals for the 2006 price and service quality review*, paras 1.5 and 3.28, Postcomm website (23 September 2006): www.psc.gov.uk/postcomm/live/policy-and-consultations/consultations/price-control/royal_mail_introduction.pdf

8 *Royal Mail after Liberalisation*, Volume II, Q 94

9 *Ibid.* para 1.5

10 Royal Mail, *Response to Postcomm’s initial proposals for the 2006 price and service quality review*, para 3.26

11 *Royal Mail after Liberalisation*, Volume II, Appendix 20, Section 3

12 *Ibid.*, Q 71

13 *Ibid.*

14 Appendix 14, paras 24 and 30

15 Royal Mail, *Response to Postcomm’s initial proposals for the 2006 price and service quality review*, para 3.33

16 *Ibid.*

Date of Valuation		Funding level (%)	Surplus (£m)	Recommended period for suspension of Company contributions
31 March 1988	POSSS	103.6	219	Recommended joint contributions of 16.3% of contributory pay
31 March 1989 (interim)	POSSS	109.6	- ¹⁷	Reduce joint contributions to 13% of contributory pay
31 March 1990 (interim)	POSSS	122.8	-	
31 March 1991	POSSS	122.4	1,442	Until 31 March 1994
31 March 1994	POSSS	104.0	374	At least until results of next valuation ie 31 March 1997
31 March 1997	POSSS	101.9	206	Until 31 August 1998
31 March 1998	POSSS	106.9	865	Until 31 March 2003, subject to review at next valuation
31 March 2000	POSSS	106.1	890	Until 31 January 2003
31 March 2003	RMPP (POSSS and POPS)	82.5	(2,500) Deficit	Nil
31 March 2004	RMPP (POSSS and POPS)	85.1	(2,670) Deficit	Nil
31 March 2005	RMPP (POSSS and POPS)	88.7	(2,200) Deficit	Nil

The 2006-2010 price control

8. In Postcomm's initial price control proposals for the 2006-2010 period, it had allowed only £776 million of Royal Mail Group's proposed capital expenditure.¹⁸ This was only half of what Royal Mail estimated it would need to modernise its business: "operational investment of £2.2 billion (comprising £1.6 billion of capital investment and £0.6 billion of one-off costs) is required over the course of the price control period for modernisation of the network infrastructure".¹⁹ Following agreement of the price controls for 2006-2010, Postcomm revised its position and allowed additional capital expenditure, up to a total of £1.2 billion over the next four years, for Royal Mail Group to modernise.²⁰

9. Postcomm told us that, within the 2006-2010 price control, it had also agreed to allow Royal Mail Group to increase its stamp charges annually to cover increased pension contributions, thereby obliging Royal Mail Group's customers to contribute at least £300

¹⁷ The dashes indicate that the figures are not available. The scheme actuary has not typically stated the amount of surplus or deficit when producing interim funding assessments (i.e. annual reviews at dates other than the dates of the formal triennial valuations), instead simply expressing the result as a percentage funding level (i.e. a ratio of assets to the value placed on the liabilities, so that a figure of over 100% indicates a surplus).

¹⁸ *Royal Mail after Liberalisation*, Volume I, para 113

¹⁹ *Ibid.*

²⁰ Appendix 6, para 12

million a year towards reducing its pension fund deficit.²¹ The Minister described this to us as reasonable, saying: “to pass a certain proportion of the costs on because when you look at the prices in the UK compared to the rest of the European market, they are still very low and in that instance the UK customer has benefited, so for the UK customer to be asked to pay part of the price I do not think is unreasonable”.²²

Proposed funding package for Royal Mail Group

10. Both the Royal Mail Group and Postcomm told us at the time of our last Royal Mail inquiry that they believed that the Group’s only shareholder, the Government, should also contribute to Royal Mail Group’s future funding requirements,²³ a belief the Royal Mail Group and the CWU reiterated during our current inquiry.²⁴ The DTI told us that it had asked Royal Mail Group to submit a business case to justify an investment by the shareholder.²⁵ That business case was formally presented by the Royal Mail Group to the Government on 14 February 2006.²⁶

11. On 18 May 2006, following discussions between the shareholder and the company, the Government announced that an agreement in principle had been reached on a new finance framework for Royal Mail Group.²⁷ According to the DTI, the proposed framework would be aimed at giving Royal Mail the freedom to develop its investment programme and reach agreement with its pension fund trustees on the terms upon which its pension deficit was to be managed.²⁸

12. The DTI told us that it intended to exercise its powers under the *Postal Services Act 2000*²⁹ to release £850 million of reserves which Royal Mail Group had built up. Royal Mail Group could then transfer those funds to a special account, the pension escrow account, which the pension fund trustees would be able to draw on should the company fail. There was also an understanding that the escrow fund would be released and surplus cash returned to the Government once the pension fund deficit had been recovered.³⁰

13. The Government also agreed, in principle, to extend Royal Mail Group’s existing debt facilities, so that £900 million of debt would be available for use by Royal Mail Group (on commercial terms).³¹ This debt facility would “be available for the company to use so that it can transform its effectiveness, secure the efficiency improvements required under the regulatory settlement and successfully compete in a newly liberalised market and that

21 Trade and Industry Committee, *Responses to the Committee’s Second Report of Session 2005-06*, Eleventh Special Report of Session 2005-06, HC 960 (hereafter ‘Eleventh Special Report’)

22 Q 134

23 Eleventh Special Report

24 Appendix 14, para 34 and Appendix 3, para 12

25 Appendix 6, para 8

26 Appendix 15, page 3

27 Appendix 6, paras 9 and 10

28 *Ibid.*

29 Section 72

30 Appendix 6, para 10

31 *Ibid.*

essentially is the money that you describe that will allow the company to move forward and ensure that it continues with its progress”.³²

14. Expenditure for Post Office Ltd, including Social Network Payments of £150 million per annum for the next two years³³ and any funding after 2008, would also be met by the Government rather than from Royal Mail Group’s reserves. The level of support after 2008 would depend on Government decisions on the future of the Post Office network.³⁴

15. Our witnesses all welcomed the proposed new financial framework.³⁵ The Royal Mail Group told us that the proposed investment package would enable it to embark on its major modernisation programme. It would also help to secure the company’s pension fund, giving the business more time to fund the pension deficit.³⁶ The CWU argued that the question of investment in Royal Mail was by far and away the most important issue facing the postal industry. It welcomed the additional refinancing to deal with the deficit: “it is also absolutely apparent that addressing the deficit is key to securing Royal Mail’s own future and in particular its ongoing ability to meet its universal service obligation”.³⁷ Its main concern was how Royal Mail intended to meet its financial commitment to paying its share.³⁸

16. During 2005–06, Royal Mail Group had an operating profit of £355 million on record revenues of more than £9 billion.³⁹ We asked the Royal Mail Group, given the financial contributions of its customers and the Government’s proposed finance package, what finance for modernisation and the deficit would be forthcoming from Royal Mail Group itself and how would this be funded. Royal Mail told us that it needed a total investment of £2 billion, and this would be funded in part by the Government loan (£900 million at commercial rates) with the rest coming from Royal Mail cash flows from the price control increase and efficiency savings of three percent per annum (predicated in the price controls).⁴⁰

17. The Royal Mail Group also said that in respect of the pension fund deficit, it had reached agreement in principle with the Trustee to “pay down the deficit over the next 17 years, with an initial payment this year of £735m (covering the 06/07 ongoing contribution and deficit correction payments). The pension deficit will be funded in part from the price control agreed with Postcomm (for the period 2006–2010) in so far as payments relate to the regulated business. The balance will be funded from Company resources”.⁴¹

32 Q 128

33 Appendix 6, para 13

34 *Ibid.*

35 For example see Appendix 3, para 12, Appendix 10, para 7.1, Appendix 13, para 5 and Qq 81-84,

36 Appendix 14, para 8

37 Appendix 3, para 11

38 *Ibid.*, para 13

39 Appendix 14, para 3

40 Appendix 15

41 Appendix 15, page 1

18. We asked the Government when the proposed financial framework would be agreed and if it thought further funding would be required in the future. The Minister told us that “the details of the framework will be set out in legal documentation currently being prepared by the Government and the company’s commercial advisers and this work is still under way.” He added, “in discussions with the company, we are confident that this amount of reserves to draw upon and confidence-building in the allocation of the pension Escrow will be enough for the company to be able to plan confidently for the future and to allow it to compete within the liberalised market, so we do not see the need to return to renegotiate any additional package”.⁴²

19. **We are encouraged to see that the Government is prepared to support the Royal Mail Group financially, albeit on a commercial basis. We would expect this of any responsible shareholder in a company needing significant investment to enable its business to flourish. We are also encouraged to see that the Government, as shareholder, has agreed to assist Royal Mail Group’s employees through helping Royal Mail Group plug its pension fund deficit.**

Royal Mail Group’s condition of acceptance

20. Royal Mail Group told us that it would only agree to the proposed financial package (a proposal it described as being essential for a deal to be reached over its pension fund deficit with its pension’s trustees) under the condition that the Government would allow a proposed employee share scheme: “we should stress that the £900m loan facility, the 17-year deficit correction payment schedule agreed with the Trustee and the £1 billion payment into the escrow account are all dependent on final agreement of the funding deal with Government. In turn, the funding deal is dependent on Government agreement to an employee share scheme, which will provide the right incentives to implement a challenging strategic plan”.⁴³

21. **We were surprised to hear from Royal Mail Group that it had had the temerity to place conditions on agreeing to the Government’s proposed financial package. We hope that the Government does not accept these conditions. We understand that the management believes the revitalisation of Royal Mail is possible only if the workforce is given the incentives to deliver the desired growth in productivity. However, the Royal Mail Group managers’ insistence that they would not accept the proposed new financing framework unless their proposed share scheme was agreed by the Government is perverse given that the company is technically insolvent (because of its pension liabilities) and especially so since—as we explain next—we have grave doubts whether the proposed share scheme would provide sufficient or appropriate incentives.**

42 Qq 128-129

43 Appendix 15, page 2

3 The ownership of Royal Mail Group

Royal Mail privatisation?

22. The *Postal Services Act 2000* recast Royal Mail Group as a plc, the issued equity of which is owned by the Government alone. The Secretary of State for Trade and Industry holds 49,999 ordinary shares with a single share held by the Treasury Solicitors. The Secretary of State also holds one special share.⁴⁴ As set out in the 1999 *Post Office Reform White Paper*,⁴⁵ the Shareholder Executive directly manages the Government's financial interests in Royal Mail.⁴⁶ The Government has pledged itself not to privatise the Royal Mail during this Parliament.⁴⁷ However, since our last inquiry into Royal Mail there has been continued speculation, especially in the media, that shares in Royal Mail Group could be divested from the Shareholder.⁴⁸

Royal Mail Group's proposals

23. The DTI told us that since Barry Gardiner MP, then Parliamentary Under Secretary of State for Competitiveness, gave evidence to us earlier this year, the Government had "received a proposal from the Royal Mail Board for an employee share scheme", a scheme which it was "carefully considering".⁴⁹ The CWU said: "given Labour's explicit manifesto commitment we believe [Allan] Leighton is abusing his position as chair of a public corporation to push for a change of ownership. This is for Government not [Allan] Leighton to determine. Issuing shares represents a sugar-coated pill on the road to future privatisation of the industry. The experience from other privatisations of UK utilities is that the issuing of shares is an opening step which ultimately leads to further share issues and eventual privatisation".⁵⁰

24. We asked the Royal Mail Group if it would outline its proposals. It told us: "what we envisage is having assigned over to the company 20% of the shares of the organisation. Those would be allocated to people absolutely equally",⁵¹ adding: "those shares would have very small initial value, but as the company grows and achieves its target those shares would grow to hopefully provide people with around £5,000 each of equity value in the Royal Mail".⁵²

44 More information on the Shareholder Executive can be found on their website (24 October 2006): www.shareholderexecutive.gov.uk

45 *Post Office Reform: A World Class Service for the 21st Century*, Cm 4340

46 Appendix 6, para 5

47 *Ibid.*, para 15

48 For example, see 'Royal Mail staff to get £5,000 in shares', *The Independent*, 19 May 2006 and 'Delivering on pensions is only start for Royal Mail', *Daily Telegraph*, 21 June 2006

49 Appendix 6, para 5

50 Appendix 3, para 16

51 Q 23

52 Q 24

25. Royal Mail Group also claimed to believe that there would be no pressure from employee shareholders to float their holdings on the stock exchange: “shares in the company go up with the value of the company, in the same way that the shares on the Stock Exchange go up with the performance of the company, and actually it is exactly the same. They are all traded within the trust, so as far as our people are concerned it is exactly the same as being outside but for our purposes it is totally inside, it is within the trust, it can never be sold outside the trust and can only be held for our people, and they get a dividend too, so they get exactly the same benefits”.⁵³

26. We asked the Government if the employee share scheme were tantamount to it breaking its manifesto commitment on the privatisation of Royal Mail. The Minister told us: “it is not my understanding that we would agree that the best description for that would be privatisation. Given that were we to agree the shares would be contained within the framework of the company and be for staff and an incentivisation scheme we do not agree that that is an appropriate description. No, we do not think that is part or full privatisation”.⁵⁴ The DTI later clarified the Government’s position. It told us that transferring twenty percent of the shares of Royal Mail Group would not lead to its reclassification (by the Office for National Statistics) from the public to the private sector. This was because the majority voting rights, the control over general corporate policy, would remain within the public sector, which would still exert the dominant influence over Royal Mail Group.⁵⁵

Efficiency gains

27. We asked our witnesses whether the proposed share scheme would prove a sufficient incentive for workers to increase their productivity. The Royal Mail Group told us: “taking our people with us is critical to our plans. We believe giving them a stake in the company is a necessary incentive to achieve the efficiency gains essential if we are to compete successfully to retain and win customers in the face of tough competition and importantly we know this is something they want and would respond to”.⁵⁶ It believed that a stake in Royal Mail Group would motivate its workforce and help it deliver the transformation it believed it needed: “our people are fundamental to our modernisation plans and we have stressed their role in the commercial investment plan we have submitted to the shareholder”.⁵⁷

28. When we asked the Royal Mail Group for evidence to back its claims of higher productivity, it told us: “the support comes from all sides: as well as academics, it comes from the private sector, from institutional investors and from governments of different persuasions all of whom put their money where their mouth is when it comes to employee share ownership”.⁵⁸ It argued, “study after study shows that there is real economic sense in employee share ownership. It is not an untried idea. It is recognised by everyone as

53 Q 50

54 Q 149

55 Appendix 7

56 Appendix 14, para 37

57 *Ibid.*, para 38

58 Appendix 15, page 4

beneficial to all parties. If there are fewer academic studies in the UK that's because UK companies haven't needed to reflect on the matter—they've just got on with it and put the plans in—and our leading companies have almost all got employee share ownership plans".⁵⁹ The Royal Mail Group produced no relevant evidence.

29. Amicus told us that, although it had not seen the exact details of the proposed scheme, "there is no evidence that share distribution would necessarily contribute to improved relationships or productivity within the organisation and the potential wide distribution of equity would not give employees any real say in the future direction of the business. Our concern is that the share option would be the sliding slope to an eventual full privatisation and ultimately the possible transference of the more profitable parts of the business into foreign hands".⁶⁰

30. The CWU said that, although it favoured a greater degree of employee involvement in the running of Royal Mail, and a permanent share in its success, it did not believe this could be done through issuing shares. It rejected the Royal Mail Group's suggestion that postal workers did not currently have an interest or 'stake' in the business: "employment in the industry, wages and a guaranteed pension represent a massive investment for all employees".⁶¹ It also suggested that "there is no clear evidence that share schemes will actually improve productivity. Indeed, postal workers have already delivered record levels of service quality without a 20% stake in the business".⁶² The union representative added "the evidence is patchy. Like you, my ears pricked up when I heard there was going to be clear, empirical evidence because I do not think there is any. It is very hard to draw any direct correlation between any pay input and an outcome to the performance of the business. It is a notoriously difficult area and with shares it is even more difficult because it is an even more roundabout way of incentivising. The bottom line is that we are the recognised trade union and if they want to talk about incentivising and rewarding staff, talk to us and we can come up with an agreement".⁶³

31. We asked the CWU if they believed the current 'share in success' scheme could be adapted to suit Royal Mail Group's efficiency requirements. It told us: "they should adapt the current share in success scheme, which is a straightforward profit-sharing scheme. We would actually propose that, in addition to that, they could include other factors, such as quality of service measures which would help trigger the payments which would add another level of performance improvement, so we think there is a far more straightforward, less costly and agreeable way of moving forward without this great share scheme with all the costs and the problems that come with it".⁶⁴ The CWU also told us that the Royal Mail Group's share proposal would be an impractical and inappropriate model for Royal Mail and that this view was supported by Job Ownership Ltd in a recent report. It argued that a collective profit share would be a better model for Royal Mail Group than imposing an

59 Appendix 15, page 5

60 Appendix 1, paras 9 and 10

61 *Ibid.*, para 18

62 Appendix 3, para 20

63 Q 101

64 Q 102

individual share plan which it said was “inappropriate” in the context of a publicly-owned Royal Mail Group.⁶⁵

Employee support for Royal Mail Group’s proposals

32. We asked the Royal Mail Group if the CWU was right in its assumption that there was little support amongst employees for a share scheme of the type proposed by Royal Mail Group’s management. They told us: “we consulted with our people [Royal Mail Group employees], and within the space, first of all, of about two weeks we had 80,000 replies from people saying that they thought this was a good idea”.⁶⁶

33. However, the CWU told us that this did not show support for the share plan among Royal Mail’s workforce since “despite offering ‘free shares’ to staff, extending the balloting deadline and boosting the return by including Royal Mail managers and sub-postmasters, just one in three (37%) of the workforce have actually registered their interest in shares”.⁶⁷ This, they described as “hardly the ringing endorsement [Allan] Leighton was seeking”. They added: “Moreover, our own poll of members found 98.5% in support of the CWU’s alternative agenda of higher basic pay, a better work-life balance and fairer workloads, maximising job security and safeguarding pensions”.⁶⁸

34. We asked Royal Mail Group and the CWU for further evidence of their balloting of Royal Mail Group’s employees to prove their claims. The Royal Mail Group provided us with a copy of a letter, concerning the proposed employee shares scheme, sent by Royal Mail Group to 208,000 employees and sub-postmasters.⁶⁹ 92,000 returns were received, of which “all but a handful were in favour of an employee share scheme”.⁷⁰ The CWU, in turn, told us that Royal Mail Group, in order to boost the return, had also sent its shares letter to “13,000 sub-postmasters (who are not even direct employees of Royal Mail) and to thousands of managers across the company; in an act of desperation, the original deadline imposed by Royal Mail was extended when only 30,000 responses were received. At this point the goalposts were shifted and managers were instructed that they could register employees themselves directly by email”.⁷¹

35. In May 2006, the CWU had held a national ballot of around 136,000 members working in Royal Mail Letters to gauge their support for the union’s views on “higher basic pay, job security, pensions and fairer workloads”.⁷² 67 percent of the ballot papers were returned, with 98 percent (66 percent of the total members balloted) voting in support of the CWU’s views. It also engaged an independent company to carry out a telephone poll along the same lines where 95 percent supported the CWU. It believed that “this high rate of return

65 Appendix 3, para 22

66 Q 28

67 Appendix 3, para 19

68 *Ibid.*

69 Appendix 15, Annex 2

70 *Ibid.*

71 Appendix 4, para 6

72 *Ibid.*, para 2

was in spite of [Royal Mail Group’s] management’s attempts to undermine the consultative ballot”⁷³.

The timetable

36. We asked the Minister whether the Government had yet reached a conclusion on Royal Mail Group’s proposals. The DTI told us that thus far no decision had been made to proceed with such a scheme, neither had the Government set a timetable for its deliberations “as we wish to carefully weigh up the pros and cons of such a scheme, taking views from a number of stakeholders, and to reach a decision that would be in the best interests of the shareholder, the tax payer, the company and its employees”.⁷⁴ The Minister confirmed that this was still the situation: “We have not pronounced on this scheme as yet. We are still studying and considering the scheme and in due course we will come forward with a view”.⁷⁵

37. **Neither the evidence provided by the Royal Mail Group nor the CWU is sufficient for us to determine if Royal Mail Group’s employees are in favour of or against the proposed share scheme. Royal Mail’s letter did not directly ask employees whether they supported the share scheme, only asking them to register an interest in order to “receive your free shares”.⁷⁶ The survey results do not therefore show that “all but a handful were in favour of an employee share scheme”,⁷⁷ as claimed by the Royal Mail Group; it is arguable rather that these employees were afraid that they would miss out on an amount of money if they did not return the form. We note that registering an interest in a putative share allocation scheme is not the same as thinking that such an allocation would be desirable. The evidence the CWU provided from their ballot asked their membership if they supported their union’s views on “higher basic pay, job security, pensions and fairer workloads”,⁷⁸ not if they were for or against the proposed share scheme. Again we feel that to rely on this ballot as proof of opposition to a share scheme is misleading.**

38. The Government told us that it would not agree to an employee share scheme, until it had taken “views from a number of stakeholders”.⁷⁹ If the Government is seriously considering the part privatisation of Royal Mail Group—even if the ownership is only extended to employees—then the Government’s priorities should be to hold a public consultation and also to ascertain the views of Royal Mail Group’s employees. This is especially necessary given the fact that no one has provided supporting evidence that such a scheme in a publicly owned plc would produce the expected results. We are unconvinced by the evidence we received which was intended to show that the employees of Royal Mail Group support, or oppose, such a proposal.

73 *Ibid.*, para 3

74 Appendix 6, para 17

75 Q 156

76 Appendix 15, Annex 2

77 *Ibid.*

78 Appendix 4, para 2

79 Appendix 6, para 5

39. Whatever view we might take on the ownership of the Royal Mail at this time, we remain unconvinced that separating a part of Royal Mail's equity from the current shareholder would act as a tool to motivate Royal Mail's workforce. The explanations offered to us by Royal Mail's current management are incomplete, lack robust evidence, and are little better than mere assertions. This may be because negotiations with the Shareholder are ongoing. However, we still believe that there are less controversial—and far more straightforward—ways for Royal Mail's management to improve motivation, such as adapting the current profit sharing scheme.

4 Post Office Card Account (POCA)

40. From April 2003, the Government began paying benefits and state pensions directly into customers' bank accounts (direct payment). The Post Office Card Account (POCA) was developed by Post Office Ltd⁸⁰ to act as a 'simple' banking vehicle whereby customers could obtain these benefits if they could not, or did not wish to, use any other kind of banking account. POCAs allow holders, or a nominated helper, to take cash out, free of charge, at any Post Office branch using a plastic card. It cannot be used for any purpose other than to receive benefit payments. For example, it cannot be used to obtain cash from ATMs or to pay bills, either directly or by direct debit, and it carries no overdraft facility. It is the electronic equivalent of the old benefits order book.⁸¹

41. Whilst the POCA offers very limited functionality, approximately forty percent of the benefit claimants converting to direct payment opened a POCA. The POCA helped Post Office Ltd retain some of the £400 million worth of transactions, which would otherwise have been lost when the Government changed to direct payment.⁸² Around 3.7 million customers of the DWP currently have their benefit or pension paid into a POCA.⁸³ HM Revenue and Customs and the Northern Ireland Social Security Agency also provide some services through the POCA,⁸⁴ taking the total number of card accounts to around 4.3 million.⁸⁵ For comparison, just over 11.6 million state pensions were paid to recipients in February 2006.⁸⁶

The cost of the POCA

42. The Department for Work and Pensions (DWP) has a contractual commitment to fund the POCA over the seven years of the contract.⁸⁷ The current POCA contract will cost the Government at least £1 billion between 2003 and 2010.⁸⁸ The precise value of the contract will depend on how many customers use the card account between now and the end of Government funding in March 2010.⁸⁹ The POCA is also partly funded by the main high street banks and the Nationwide Building Society, who together will contribute £180 million over the period 2003–08 on a voluntary basis.⁹⁰ Royal Mail Group earns around £195 million annually from the POCA contract.⁹¹

80 Offered by J. P. Morgan Europe Ltd through Post Office Ltd.

81 Appendix 5, para 2

82 Appendix 13, para 11

83 Appendix 5, para 2

84 HC Deb, 26 January 2006, c444W

85 Appendix 14, para 47

86 DWP website (24 October 2006): www.dwp.gov.uk/asd/tabtool.asp

87 Appendix 7, page 2

88 *Ibid.*

89 HC Deb, 26 January 2006, c444W

90 Appendix 7, page 2

91 Q 63

43. The Citizens Advice Bureau (CAB) considered that the reason for the termination of the POCA contract was “almost certainly financial, given that the cost per transaction to government for payments into a POCA is apparently £1 whereas payments into bank accounts cost just 1p”.⁹² The DWP confirmed that these were the relative costs of the POCA and added: “80 per cent of our payment costs go on the 23 per cent of customers who are paid by Post Office card account”.⁹³

44. However, we were informed by the NFSP that these figures were not entirely accurate: “The Post Office, we are led to understand, have got a rate card for their services to banks *et cetera*, and their rate is something in the region of £45 per year to the DWP for the Post Office Card Account. This figure has become loosely equated to being, with some minor additions to that which they might call VAT *et cetera*, around £52 a year, hence £1 a week”.⁹⁴ If, as is likely, many customers receive one payment a week, this £1 a week would explain the £1 per payment figure given by the Government. The NFSP continued: “the one penny, I am led to understand, is the BACS cost of a transfer through any BACS system, and of course the banks then pick it up or the customer, of course, if they get into difficulties or if they are paying direct debits out or whatever else at their particular end. Going to your latter point about what do sub-postmasters get, there is an initial payment—or was an initial payment because there are not very many of them being opened these days—where a sub postmaster gets the equivalent of £2.60 for every account that is actually opened as a one-off payment, and currently sub-postmasters are paid 15p per £100 for monies drawn out of that card account”.⁹⁵

45. As we indicate later in this Report, the perceived financial benefit for the taxpayer from DWP’s ending of the POCA is questionable if these revenues for Post Office branches continue to be found from the public purse in the form of increased subsidy payments to keep the network afloat—always assuming that the size of the current network be maintained.

Misleading information

46. In January 2006, it became apparent that the DWP would not be renewing its contract with Post Office Ltd after the end of the current contract, all but bringing an end to the POCA in its current form.⁹⁶

47. While the current contract comes up for renewal in 2010, it has always been the understanding of the NFSP that POCAs would be continued beyond then. The NFSP suggested that the Government had stated at the time of the introduction of POCAs that the card account or an equivalent scheme would be guaranteed. The NFSP quoted a 2003 joint DWP/DTI statement, which described the POCA as “the cornerstone” of new banking products at the Post Office. The NFSP also maintained that POCA customers, the

92 Appendix 2, para 3.4

93 Appendix 5, para 2

94 Q 209

95 *Ibid.*

96 Appendix 10, para 3.8

NFSP and MPs were never at any stage informed that the POCA was a short-term or temporary scheme.⁹⁷

48. When our predecessors took evidence in the last Parliament on direct payments, they were led to believe by the Government that the POCA would replace the business that would be lost through the change in benefit payments arrangements. There was no suggestion it was temporary. We wanted to know what had changed since then. The Minister told us: “I do not think anything changed. The contracts that were signed and agreed were of seven years duration and those contracts are due to expire in 2010, therefore they have to be renewed, revisited or altered”.⁹⁸ The Minister also claimed that all the parties involved in developing the POCA contract knew that the contract would not be extended.⁹⁹

49. We asked our other witnesses whether they thought the Government had made the involved parties sufficiently aware that the POCA contract would not continue after 2010. Mr Cook, Managing Director of Post Office Ltd, told us that the Royal Mail Group organisation “had an expectation that there would be a continuing need for a method of providing benefit payment to individuals who do not have a bank account. My belief is that whilst this contract will end in 2010, there will still be a continuing need, maybe not on the same scale, for individuals to receive their benefit payment in cash in some mechanism”.¹⁰⁰ The CWU were also unaware that the contract would not be renewed: “simply, no, we were not [aware]. The Post Office Card Account came into being in 2003 and was only fully rolled out to the whole of the UK from April 2005, as there was a two-year migration programme, so in reality it has only been up and running for just over a year. Our belief was that it was going to be extended beyond the life of the contract”.¹⁰¹

50. The NFSP told us that during the monthly meetings it had with the DWP and Post Office Ltd drawing up the POCA, it was “not told that it was going to end in 2010”.¹⁰² It further claimed: “nor was anybody else. As you know, the customers had to sign up, although it was a convoluted process to sign up for a Post Office Card Account. None of those opened that card account thinking it was going to end in 2010, not a piece of mention was in that literature. You do not go and open a bank account, for example, and think the banks are going to close the account down, do you,”¹⁰³ and later “I believe that everyone thought, even those that knew that this contract was for a term—and I suppose if we had thought about it we would have expected that all contracts are for a term and do not last forever—there was an expectation on everyone’s part that during the period between 2003 and 2010 we would be working together to find the 2010 equivalent of the Post Office Card Account, but in fact what happened, as we know, is less than a year after

97 Appendix 10, para 3.9

98 Q 165

99 Qq 170-174

100 Q 70 (Mr Cook)

101 Q 115

102 Q 200 (Mr Baker)

103 *Ibid.* (Mr Peberdy)

the last order book was cashed the account was called time on, which I think took everyone by surprise".¹⁰⁴

51. We do not believe that the Government deliberately set out to mislead our predecessor Committee with regards to the longevity of the POCA. However, nor do we believe that the Government made clear the possibility that the contract would not be renewed. Most of the DWP's partners in the POCA assumed that the contract would be renegotiated after 2010. This has, quite understandably, led to a lot of bad feelings amongst these partners and a sense of betrayal amongst sub-postmasters. Sub-postmasters will have made business decisions based on the understandable, but ultimately false, expectation that the contract would be renewed. We note that the Minister is now holding out the possibility of a substitute for the POCA. We would welcome any clarification of what this would be.

The Post Office Network

52. With 14,500 branches, the Post Office is the largest retail and financial services chain in the UK. It is larger than the largest bank network (2,500 branches¹⁰⁵) and all of the UK's banks and building societies combined, and it has branches in locations where banks and building society branches have ceased to exist. It is also larger than any of the major high street stores (2,000 branches).¹⁰⁶ 94 percent of the population live within a mile of a Post Office branch and 28 million customers visit one every week.¹⁰⁷

Income for Post Office branches

53. As a company, Post Office Ltd depends on a small number of large clients for the bulk of its income. Just two clients—the DWP and Royal Mail—have accounted for around sixty percent of its income.¹⁰⁸ The Post Office network's income from Government—in the past one of its main sources of revenue—fell by £168 million in 2005-06, as more benefits were paid directly into bank accounts.¹⁰⁹ This trend is expected to continue: "in five years' time less than 10% of Post Office Ltd's income will come from the Government".¹¹⁰

54. NFSP research has found that POCA transactions bring in an average of £249 income for sub-postmasters per month, which amounted to 10 percent of their net pay. Sub-postmasters in urban deprived areas were most dependent on card accounts as a source of income, as POCA's brought them an average of £403 or 12 percent of net pay.¹¹¹ By contrast, the NFSP's research revealed that sales of Post Office financial services including personal loans, credit cards, instant saver accounts, guaranteed equity bonds, growth bonds, child trust fund, car insurance and home insurance generated an average of just £7

104 Q 208 (Mr Baker)

105 Q 167

106 *Ibid.*

107 Appendix 10, para 2.1

108 Appendix 14, para 42

109 *Ibid.*

110 *Ibid.*

111 Appendix 2, para 8.1

per month income for sub-postmasters, while 58 percent of sub-postmasters received no income whatsoever from such sales.¹¹²

Post Office branch closures

55. The DWP's decision to discontinue funding the POCA is likely to have an impact on the viability of some individual Post Office branches. Royal Mail Group told us that one of the main purposes of Post Office branches was to get "the right amount of cash in the right town on the right day of the week so people can collect benefits, and that second part of the whole purpose of the Post Office is rapidly disappearing".¹¹³ The CAB considered that "the great unknown is whether people will choose to undertake bank account transactions at Post Office counters or whether the business will be lost to the network altogether".¹¹⁴ Use of POCAs not only results in a transaction fee for sub-postmasters, "it also brings in the opportunity for sales of other products, either at the Post Office counter or in the attached retail unit. Such sales help support the financial viability of the retail unit as a whole".¹¹⁵

56. The DWP told us: "there is no reason why the end of Post Office card account funding in March 2010, as always planned, should automatically lead to Post Office closures. There is also no reason why Post Office Ltd should not be able to retain the business of existing Post Office card account customers if it offers them the services they want, or, indeed, if it improves on what is currently available via a Post Office card account through its own new products".¹¹⁶

57. The DWP also stated: "there have been claims that there will be significant Post Office closures or that customers will no longer be able to collect their benefit or pension at the Post Office. Such claims are misleading, are worrying customers unnecessarily and are not in Post Office Ltd's own interests".¹¹⁷

58. However, we heard that, in light of the end of the POCAs Royal Mail Group wished to reduce the Post Office network to 4,000 offices.¹¹⁸ We asked Royal Mail Group if there was any truth in these rumours. Alan Cook, Managing Director of Post Office Ltd, told us that "a commercially viable network would be around 4,000,"¹¹⁹ but later added: "I do not have an aspiration to run a network on 4,000, but if you wanted the optimum commercially viable network, it would be 4,000".¹²⁰ The Minister agreed that the current network could not be maintained: "sadly, I do not think it is sustainable to be able to continue with 14,500 sub-Post Offices across the country people just are not using the sub-Post Office and the Post Office as they used to previously. There is a whole variety of different ways for people to be able to access services, and that is not to criticise, this is a modern age, we have

112 *Ibid.*, para 6.7

113 Q 63

114 Appendix 13, para 47

115 *Ibid.*, para 49

116 Appendix 5, para 2

117 *Ibid.*

118 Appendix 12, para 4

119 Q 59

120 Q 60

got to equip the Post Office with the ability to go out into the market to provide services”.¹²¹

59. We pressed the Minister further about the number of Post Office branches the Government thought would be optimal. He told us: “we have a starting point of at least 4,000 which would be able to survive in the hard-faced commercial world. The difficulty I have got, sir—and, forgive me, I would love to be more helpful—is if I were to put a figure anywhere between 4,000 and 14,500 to the Committee today that would almost automatically become Government policy and a Government statement”.¹²² The Government’s stance over the future size of the Post Office network is something that we return to at the end of this Report.

60. We were interested in finding out if a Post Office network of 4,000 branches would be sufficient for the Royal Mail Group to fulfil its universal service obligation. Postcomm told us: “we have not seen any evidence to support the assertion that this is all that would be needed to meet the Universal Service Obligation. Our view is that such a reduction would break the terms of Royal Mail’s licence, as it would not be serving the reasonable needs of customers in terms of access to postal services”.¹²³

Rural Post Office network

61. The Royal Mail Group told us: “the most pressing issue for the Post Office network involves creating a sustainable future for the rural service, where the majority of the 7,854 branches are fundamentally loss-making and have depended on the £150 million of funding made available by the Government to stay open. The rural branches make up more than half the total number of branches in the network, but they account for less than 10% of total business. Some 1,000 branches serve fewer than 50 customers each week”.¹²⁴

62. Help the Aged, Postwatch, the CWU and the CAB were also concerned about the impact the closure of POCA would have on the Post Office network, especially in rural areas. Help the Aged told us: “further Post Office closures will mean that vulnerable older people will have to increasingly rely on ATMs, some of which charge for access to cash”.¹²⁵ Postwatch suggested: “customers are uncertain about future methods of payment for their benefits, and are concerned about the continuity of a valued local service”.¹²⁶ Postwatch believes the Government needs to recognise the impact of its decisions on the viability of the Post Office network, and produce a coherent, cross-government strategy for the network’s future.¹²⁷

63. The CWU told us that the end of the POCA would “have a devastating effect on the whole of the network”, particularly rural communities.¹²⁸ It further believed that the end of

121 Q 177

122 Q 181

123 Appendix 12, para 4

124 Appendix 14, para 45

125 Appendix 8

126 Appendix 13, para 49

127 *Ibid.*, para 50

128 Q 116

the POCA would impact on the wider communities: “customers living in a village or a more rural area are less likely to withdraw their benefits from a cashpoint or a bank or building society and they are more likely to withdraw their cash over the counter at Post Offices. The stats are that just 4% of rural areas have a bank, whereas 60% of rural areas have a Post Office, so it is a given that people in rural communities will draw their money at the Post Office”.¹²⁹ However, it produced no further evidence to substantiate that conclusion. The CAB stated: “if the contract for the POCA is not renewed after 2010 it will remove another important revenue stream for sub-postmasters. This change will threaten the profitability of certain Post Office branches, particularly those in rural or urban deprived areas, at a time when the future of the subsidy for rural Post Offices is under review, and where the threat of a wave of branch closures cannot be ruled out”.¹³⁰

64. The POCA is the second highest earner for rural Post Office branches, second only to postage work.¹³¹ NFSP’s research found that rural sub-postmasters received an average of £158 per month (8% of net pay) for POCA transactions. After POCA transactions, the next highest income source for sub-postmasters was from services payments. On average, payments brought in £132 (5% of net pay).¹³² This covered dealing with Post Office customers’ payments for services ranging from electricity and gas to cable television, telecommunications and council tax and a range of bill issuers.¹³³ However, this income source is also under threat. Alternative suppliers have developed bill payment services which are available in local shops, for example PayPoint. These alternative suppliers have been awarded some of the contracts previously held by Post Office Ltd. The most recent example was when, in April 2006, the TV Licensing contract was awarded to PayPoint.¹³⁴

65. The Highland Council were worried about the impact falling incomes for Post Office branches would have on the wider rural community: “With many of the services provided at Post Offices still remaining unprofitable it will be important that some public service subsidy is retained. This will be particularly important to remote peripheral and rural communities, where access to an adjacent Post Office could mean a round trip of over 30 miles. It must be recognised that Rural Post Office Services are not simply a public service in their own right. Many rural Post Offices exist as part of another private enterprise such as the running of a rural shop. The partnership approach is an essential feature of most rural Post Offices where the demise of one part of the partnership can undermine the profitability of the whole business enterprise. The subsidy to Post Office Ltd to continue the support of rural, and most likely unprofitable, Post Office services allowed many wider community services to be retained”.¹³⁵

66. The rural part of the network is currently supported by the ‘Social Network Payment’, a payment of £150 million a year that helps Post Office Ltd meet the cost of maintaining the non-commercial part of the rural Post Office network and to test new ways of delivering

129 Q 118

130 Appendix 2, para 2.9

131 Q 213

132 Appendix 10, para 4.7

133 *Ibid.*, para 4.5

134 *Ibid.*, para 4.7

135 Appendix 9

services into rural areas.¹³⁶ With 7,854 rural Post Office branches,¹³⁷ that amounts to an average subsidy of just over £19,000 annually. The DTI told us that, as part of the new financial framework, “expenditure for Post Office Ltd, including Social Network Payments of £150 million per annum for the next two years¹³⁸ and any funding after 2008, would also be met by the Government rather than from Royal Mail Group’s reserves (the level of support after 2008 would depend on Government decisions on the future of the Post Office network)”.¹³⁹

67. The Government has committed itself to payments for the Social Network until 2008. It has also agreed to consult with regards to any decision it takes on the Social Network for the post 2008 period. We will watch with interest the form and outcome of such consultation, which must be conducted in the most open and thorough manner and with a reasonable period for interested parties to respond.

68. The rapid pace of change throughout financial services presents unavoidable challenges for Post Office Ltd. It is almost inevitable that Post Office branch incomes will fall over the coming years as customers become more financially aware and naturally graduate to bank accounts (including internet banking), which can offer them greater functionality, such as bill payment. We regret that Government policy is accelerating this process.

69. With the reduction in income for Post Office branches from the termination of the POCA, coupled with a fall in income from other sources, we are very worried about the future of the Post Office network as it stands today. We are especially concerned about the impact on the commercially unviable parts of the network, and the implications Post Office branch closures would have on their wider communities.

The future of the Post Office network

70. We asked Royal Mail Group what size of Post Office network it envisaged, given the falling demand for its services, such as the withdrawal of the POCA. Alan Cook, Managing Director of Post Office Ltd, told us it: “is really for government to determine. It is really clear that they have to decide exactly what scale of network, or, if you like, community provision they would feel appropriate”.¹⁴⁰ When pressed on what he thought would be a viable network, Mr Cook told us that “a commercially viable network would be around 4,000”.¹⁴¹

71. The Minister told us that the Government thought the final number of Post Office branches should be higher than 4,000 but that it was still deciding on the size of the

136 Appendix 13, para 44

137 Appendix 14, para 45

138 Appendix 6, para 13

139 *Ibid.*

140 Q 64

141 Q 59

network as it had “a community obligation as well as a commercial obligation and that is what is being examined at the moment”.¹⁴²

72. We asked the Minister whether, given the ending of the POCA and apparent lack of direction for the Post Office network, the Government had given up on the Post Office network. The Minister told us: “I do not think the Government is giving up on the Post Office Network. I referred earlier on to the commitment that the Government has demonstrated since 1999 where we have committed some £2 billion to the Post Office: £500 million helped fund the Horizon IT infrastructure which has had a direct effect on POL’s [Post Office Ltd’s] ability to secure and expand new business such as online banking facilities, and the E-top-up market which has generated revenue to POL of £340 million, we have committed £150 million per year, as you know, to support the rural network, we have spent £210 million to support the urban re-invention network and some £30 million of investment to modernise branches, as well as £25 million into pilots to examine how we can best deliver services in a different way to rural areas which might not be able to support and sustain their own sub-Post Office”.¹⁴³ He added: “we are examining the future of the network at this very point. We know that we have got time-limited support for the rural network because we have committed ourselves to £150 million to 2008; we are of the opinion that that cannot continue”.¹⁴⁴

73. If the Post Office network were just a commercial entity, it would not deserve to be supported by Government. However, it fulfils a wider community need. In many places Post Office branches serve as the heart of the community.

74. Some Post Office branches, especially those in rural areas, will always remain unviable. We believe that it is vital that across the whole of Government there is a clear recognition of the role that Post Offices play in delivering Government objectives in the community. Decisions are needed by the Government now to plan the Post Office network for the future, taking into account postal services and the wider social functions provided by Post Offices in local communities. If the Government fails to act, the network and all the benefits it provides for communities could be lost forever.

Financial exclusion

75. The NFSP believed that Post Office closures, which it said would result from the withdrawal of the POCA, would further impoverish choice and access to goods and services in many communities in the UK through the knock-on closure of other local businesses, with socially and financially excluded groups the hardest hit: “as well as boosting local economies, Post Offices provide a well-documented and critical social role in communities across the country, providing direct support and advice for vulnerable local residents, including elderly and disabled people, and acting as a focal point for communities”.¹⁴⁵

142 Q 167

143 Q 175

144 Q 176

145 Appendix 10, paras 6.3-6.4

76. Financial exclusion is one of the key factors in wider social exclusion: “in 2002–03 1.9 million households (which equates to around 2.8 million adults) in the UK were without a bank account of any kind”.¹⁴⁶ A fall in the size of the Post Office network would reduce access to free cash withdrawals and banking for many customers at a time when the high street banks were reducing their networks: “the University of Nottingham found that it is poorest areas which suffer disproportionately high rates of bank and building society branch closures. Nearly 6,000 bank branches have closed since 1990, leaving 1,000 mainly rural communities bankless. Only 4% of villages have a bank branch, while 60% have a Post Office”.¹⁴⁷

77. The DWP told us that it aimed to reduce any impact the end of POCAs would have on financially excluded customers: “We want people to continue to access their cash at the Post Office and are working with Post Office Ltd and other stakeholders on what options will be available to customers after the card account ends, including the form of any alternative products to the Post Office card account. All existing Post Office card account customers will still be able to use the Post Office to collect their benefit or pension if they wish by using a bank account there and Post Office Ltd will still receive a payment for providing this service”.¹⁴⁸ The Minister told us that this would be done as “the contracts that were signed were signed until 2010; we gave an assurance in the 1999 White Paper that individual citizens would be able, regardless, to collect their benefits at a Post Office or a sub Post Office, and we are holding to that”.¹⁴⁹

78. The Government is rightly concerned about financial exclusion. This is not just a question of encouraging participation in banking services, it is about access in some areas to the most basic of banking services: access to cash. The Post Office is often the only outlet offering free access to cash for people in deprived areas, be they urban or rural. For many their Post Office branch provides access to vital services, such as bill payments. We welcome the Government’s agreement to make social network payments for the next two years. However, we recommend that the Government should now commit itself in principle to making social network payments for the period post 2008. This would reduce the anxiety currently felt by many customers and sub-postmasters.

Migrating customers away from POCAs

79. The POCA contract obliges both Post Office Ltd and DWP to help migrate customers to alternative accounts during the seven-year period of the contract.¹⁵⁰ The DWP ran a number of small-scale POCA pilots between 13 February and 10 March 2006 to test its various approaches to moving people from having their benefit or pension paid into a POCA to payments into a bank account: “our emphasis was on those bank accounts which can be used at Post Office branches.”¹⁵¹

¹⁴⁶ Appendix 5, para 1

¹⁴⁷ Appendix 10, para 5.4

¹⁴⁸ Appendix 5, paras 2-3

¹⁴⁹ Q 169

¹⁵⁰ Appendix 5, para 2

¹⁵¹ *Ibid.*, para 4

80. The pilots were designed to gather information about customer needs to help the DWP and Post Office Ltd plan the transition between now and when the POCA contract ends in 2010. The stated aim of the pilots was “to see how customers would react, including how many people would continue to use the Post Office, and how much we can contribute to the wider financial inclusion agenda by encouraging some people to open a bank account for the first time”.¹⁵² The DWP told us that the three pilots involved:

- **Pilot A:** not promoting the option to open a new POCA for 3,000 customers making a new claim for Jobseeker’s Allowance, State Pension or Pension Credit;
- **Pilot B:** writing to 25,000 customers paid by POCA asking them to supply their bank account details. There were some follow-up telephone calls to check if customers had received their letter and if they had any further questions or needed help to open a new account; and
- **Pilot C:** writing to 1,500 customers who had one benefit paid into a POCA and another into a bank account saying that the DWP intended to pay both their benefits into their bank account in future.¹⁵³

81. The NFSP viewed the pilots very differently from the DWP. It argued, “over 40,000 current or potential POCA users [were] refused access to the facility without their consent. 3,000 new benefit claimants were not given the option to open a POCA; 35,000 existing customers received a letter from the DWP telling them to use a bank or building society account and demanding their account details; while 2,500 existing customers, without choice or consultation, found their benefits are no longer paid into their card accounts, but paid instead into a bank account, totally ignoring the preferences made when their benefit books were stopped”.¹⁵⁴ The NFSP’s figures are notably different from the DWP’s figures. Given that it was the DWP who commissioned the pilots, it surprises us that the NFSP did not say whence their figures came.

82. We asked the Government when the results of these pilots would be made available to Parliament and the Royal Mail Group. The DWP told us, “we have already shared the key findings with Post Office Ltd to help them identify customer needs as they develop new savings and banking products which are likely to be more attractive to many of their customers than the current Post Office card account”.¹⁵⁵ In July 2006, the DWP also placed a summary report of the key findings of the POCA pilots in the House of Commons Library.¹⁵⁶ These were that: POCA numbers fell significantly across all customer groups, with a reduction in customers wishing to be paid by DWP cheque as well; during migration the DWP will need to provide additional support and information to some customers about why they have to change; and of the 300,000 POCA holders who had one

¹⁵² *Ibid.*

¹⁵³ *Ibid.*

¹⁵⁴ Appendix 10, para 3.11

¹⁵⁵ Appendix 5, para 4

¹⁵⁶ HC DEP 06/1420

benefit paid into their POCA and another into a bank account, the majority would accept having their benefits paid into their bank account only.¹⁵⁷

83. The DWP suggested that the key findings of its pilots would enable Post Office Ltd to “help them identify customers’ needs”.¹⁵⁸ We cannot see how this is so. The key findings give no indication of what customers want instead of their POCAs as they were refused the choice of keeping the POCA, or an as yet undeveloped alternative. Customers may have feared that if they did not comply with the DWP’s requests they would have their benefits stopped. We are not convinced that these pilots were carried out in a methodologically sound way, and so we cannot comment on whether their conclusions were in fact valid.

An alternative to the POCA

84. We noted the evidence which suggested that there was currently no alternative product available to DWP’s customers that would suit those who needed to retain an account such as the POCA.¹⁵⁹ We asked our witnesses if there was anyone who would still need a POCA, or its equivalent, once the DWP contract finished. Our witnesses identified three such groups of customers and the types of products or services which they thought would be required to meet customers’ needs.¹⁶⁰

85. Customers who could not open a bank account: These individuals would need a basic account which could be accessed in every high street and village. Postwatch suggested that a continuing partnership between the DWP and Post Office Ltd “appears the most suitable and sustainable answer to these customer needs—preferably with a product that offers greater functionality than the Post Office card account”.¹⁶¹ The CAB told us that for this kind of product to be successful, the process of opening basic bank accounts needed to be made easier, including greater flexibility over ID requirements.¹⁶²

86. Customers who had a bank account but had chosen to have their benefits paid into a POCA: Although the motivation of these customers was not fully understood, their needs could be met through the development of a basic bank account as suggested above.¹⁶³ The NFSP suggested that this could be provided by outside banks but only if all bank accounts were made accessible at Post Office counters¹⁶⁴ (at present 60% of accounts cannot be accessed there¹⁶⁵). The CAB told us that if banks were allowed to provide these services, “support should be available for people to open and use bank accounts”.¹⁶⁶

¹⁵⁷ *Ibid.*

¹⁵⁸ Appendix 5, para 4

¹⁵⁹ For example see Appendix 10, para 3.10 and Appendix 13, paras 24-25

¹⁶⁰ Appendix 13, para 26

¹⁶¹ *Ibid.*

¹⁶² Appendix 2, para 2.8

¹⁶³ Appendix 13, para 26

¹⁶⁴ Appendix 10, para 5.7

¹⁶⁵ Q 215

¹⁶⁶ Appendix 2, para 2.8

87. Customers who used their POCA as an easily accessible savings account, ring-fenced from their current account: These customers would benefit from a Post Office savings account which offered them interest,¹⁶⁷ such as the Post Office’s new Instant Saver account.¹⁶⁸

88. The Royal Mail Group suggested that there would be a need for a product that would enable individuals who, even after some further encouragement to open a bank account, chose for whatever reason not to do so.¹⁶⁹ The Minister believed that the creation of such an account would be possible: “There has been an examination going on since the arrival of POCA and if we can arrive at an alternative which meets the purposes of the requirement to make sure that anybody can get their benefits and cash at a Post Office then obviously we need to do that”.¹⁷⁰

89. The DWP told us: “Post Office Ltd has introduced one new savings account, and is developing other savings and banking products which are likely to be more attractive to many of its customers than the current Post Office card account. More can be done for financial inclusion if these new products are better targeted on the customers without bank accounts, and perhaps offer some services the Post Office card account does not—for example, the ability to pay in cash and cheques”.¹⁷¹

90. We asked the Royal Mail Group about the products it was developing. It told us: “one of the suggestions ... we are now investigating jointly [with DWP], is that we create a new entry level savings account as a Post Office product where individuals then would have their benefit paid into that entry level savings account and I would pay them interest. The remuneration would be nowhere near as significant as I am getting today, because I would then just be running it as a savings account and earning a margin on the difference between the money I have got in the bank and the money that I pay the individual in terms of interest, but that would retain the footfall and it would retain some level of income”.¹⁷² Unfortunately, our witnesses were not able to indicate what sort of reduction they envisaged in the income of sub-postmasters with an alternative to the POCA. We are surprised that Royal Mail Group appears not to have investigated this matter further.

91. We are concerned that the DWP’s pilot did not include a similar alternative to the POCA. We do not believe that it is beyond the Post Office and DWP to offer customers an alternative product which, while retaining the advantages of the POCA, would also offer the greater functionality of a mainstream bank account. The DWP has so far released just the preliminary findings of its pilots and we will watch its full conclusions with great interest.

92. Also, although it is accepted that an alternative is likely to be less profitable to Royal Mail Group than the POCA, we still do not know what impact it would have on the

¹⁶⁷ Appendix 13, para 26

¹⁶⁸ HC Deb, 4 September 2006, c1997-8W

¹⁶⁹ Appendix 14, para 49

¹⁷⁰ Q166

¹⁷¹ Appendix 5, para 2

¹⁷² Q 74 (Mr Cook)

income of sub-postmasters. Indeed, an alternative offering with more functions, such as an ability to make deposits, might increase their income directly or indirectly, through greater footfall.

Joined up government

93. The NFSP and CWU were concerned that the DWP had been acting in isolation from other Government Departments on the issue of the POCA and was “failing to recognise the much wider social and economic implications of withdrawing the POCA without a Post Office based alternative in place”.¹⁷³

94. While ending the POCAs would represent a short-term saving to the DWP, the CWU was concerned that these decisions had been made without having joined-up government thinking in terms of the DTI and the wider social and economic costs that such a move would trigger: “We have a major concern here that one decision by one government body is actually impacting detrimentally on another government body, so the bottom line is that we have not been consulted on this”.¹⁷⁴

95. The NFSP also told us: “the Government have got to start to think of its departments (a) in a joined-up manner and (b) to some degree think Post Office first. It is an absolute no-brainer as you have already said: they are paying out money with one hand to keep the network going and taking the means of earning a living away with the other—the DVLA *et cetera*”.¹⁷⁵

96. We suggested to the Minister that there should be a more joined-up Government policy for the future of the Post Office network. He said: “we have to look at this as government across departments, identifying the need of each department and the role that it will play in being able to potentially assist the network and being able to survive, whether that is financially or with resources or with tasks or with contracts”.¹⁷⁶ He also explained that a Cabinet sub-committee, Miscellaneous 33, had been set up and will be formally bringing Government departments together to examine the issue of the Post Office network.¹⁷⁷ We asked when this committee would be reporting its findings. The Minister replied: “we have not got a date for formal reporting back”¹⁷⁸ but that “given that the SNP [Social Network Payment] runs out in 2008 we clearly have a backstop. We do have the pilot evidence, which was only completed in March of this year, which is being examined, and we do have the commitment to a further consultation period because we are not going to make an announcement and say that is the conclusion, we are going to allow people the opportunity to express a view”.¹⁷⁹

173 Appendix 10, paras 3.15

174 Q 119

175 Q 216

176 Q 178

177 Q 182

178 Q 184

179 Q 185

97. Historically the UK has enjoyed the benefits of a comprehensive network of sub-Post Offices, often in very remote, rural locations, because of the wide range of services the Government chose to deliver through those Post Offices. On top of unavoidable technological and social change, which have reduced client footfall, the Government is now withdrawing services from the Post Offices. If the country wants a comprehensive network of Post Offices to continue, a more explicit funding mechanism must be put in place, together with product diversification and a replacement for the Post Office Card Account.

98. There has been a lack of joined-up thinking between Government departments, perhaps to be addressed, at last, by the Cabinet sub-committee. The DWP is undermining the Post Office network by removing the Post Office Card Account, although the Government now appears to be considering the need for a substitute. The end of the Post Office Card Account has been the most serious but not the only cause of the present difficulties, as decisions by the BBC and the DVLA (with respect to licensing) have also removed income from Post Offices. Given that the DTI then have to put money in to keep the network going, taxpayers' money is going round in a circle, while there is a climate of uncertainty for sub-postmasters. This makes no sense to us.

99. We are seriously concerned about the apparent lack of urgency in the remit given to the Cabinet sub-committee examining the future of the Post Office network. Sub-Post Offices have already lost sources of income, and postmasters will be making decisions now on whether they can sustain their business. There is a danger of seeing considerable closures before the Social Network Payment ends, unless postmasters are given a much better indication of future sources of income after 2008.

100. There appears to be widespread, if reluctant, acceptance among our witnesses that a network of 14,500 branches is unsustainable. Postcomm has said that a network of 4,000 Post Offices could breach the universal service obligation. We expect the Government to work with Royal Mail Group and the regulator to determine the size and shape of a network that would meet the universal service obligation. Once this is done, if some individual Post Offices which are judged to provide a valuable social service are still incapable of making a profit, then the Government should be prepared to continue a subsidy to parts of the network post 2008. It should make this commitment as a matter of urgency.

Conclusions and recommendations

A new financial framework

1. We are encouraged to see that the Government is prepared to support the Royal Mail Group financially, albeit on a commercial basis. We would expect this of any responsible shareholder in a company needing significant investment to enable its business to flourish. We are also encouraged to see that the Government, as shareholder, has agreed to assist Royal Mail Group's employees through helping Royal Mail Group plug its pension fund deficit. (Paragraph 19)
2. We were surprised to hear from Royal Mail Group that it had had the temerity to place conditions on agreeing to the Government's proposed financial package. We hope the Government does not accept these conditions. We understand that the management believes the revitalisation of Royal Mail is possible only if the workforce is given the incentives to deliver the desired growth in productivity. However, the Royal Mail Group managers' insistence that they would not accept the new financing framework unless their proposed share scheme was agreed by the Government is perverse given that the company is technically insolvent (because of its pension liabilities) and especially so since we have grave doubts whether the proposed share scheme would provide sufficient or appropriate incentives. (Paragraph 21)

Ownership of the Royal Mail Group

3. Neither the Royal Mail Group nor the CWU has provided sufficient evidence for us to determine if Royal Mail Group's employees are in favour of or against the proposed share scheme. Royal Mail's letter did not directly ask employees whether they supported the share scheme, only asking them to register an interest in order to "receive your free shares". The survey results do not therefore show that "all but a handful were in favour of an employee share scheme", as claimed by the Royal Mail Group; it is arguable rather that these employees were afraid that they would miss out on an amount of money if they did not return the form. Registering an interest in a putative share allocation scheme is not the same as thinking that such an allocation would be desirable. The evidence the CWU provided from their ballot asked their membership if they supported their union's views on "higher basic pay, job security, pensions and fairer workloads", not if they were for or against the proposed share scheme. Again we feel that to rely on this ballot as proof of opposition to a share scheme is misleading. (Paragraph 37)
4. The Government told us that it would not agree to an employee share scheme, until it had taken "views from a number of stakeholders". If the Government is seriously considering the part privatisation of Royal Mail Group—even if the ownership is only extended to employees—then the Government's priorities should be to hold a public consultation and also to ascertain the views of Royal Mail Group's employees. This is especially necessary given the fact that no one has provided supporting evidence that such a scheme in a publicly owned plc would produce the expected results. (Paragraph 38)

5. Whatever view we might take on the ownership of the Royal Mail at this time, we remain unconvinced that separating a part of Royal Mail's equity from the current shareholder would act as a tool to motivate Royal Mail's workforce. The explanations offered to us by Royal Mail's current management are incomplete, lack robust evidence, and are little better than mere assertions. This may be because negotiations with the Shareholder are ongoing. However, we still believe that there are less controversial—and far more straightforward—ways for Royal Mail's management to improve motivation, such as adapting the current profit sharing scheme. (Paragraph 39)

Post Office Card Account

6. We do not believe that the Government deliberately set out to mislead our predecessor Committee with regards to the longevity of the POCA. However, nor do we believe that the Government made clear the possibility that the contract would not be renewed. Most of the DWP's partners in the POCA assumed that the contract would be renegotiated after 2010. This has, quite understandably, led to a lot of bad feelings amongst these partners and a sense of betrayal amongst sub-postmasters. Sub-postmasters will have made business decisions based on the understandable, but ultimately false, expectation that the contract would be renewed. We note that the Minister is now holding out the possibility of a substitute for the POCA. We would welcome any clarification of what this would be. (Paragraph 51)
7. The DWP suggested that the key findings of its pilots would enable Post Office Ltd to "help them identify customers' needs". We cannot see how this is so. The key findings give no indication of what customers want instead of their POCAs as they were refused the choice of keeping the POCA, or an as yet undeveloped alternative. Customers may have feared that if they did not comply with the DWP's requests they would have their benefits stopped. We are not convinced that these pilots were carried out in a methodologically sound way, and so we cannot comment on whether their conclusions were in fact valid. (Paragraph 83)
8. We are concerned that the DWP's pilot did not include an alternative to the POCA. We do not believe that it is beyond the Post Office and DWP to offer customers an alternative product to the POCA which, while retaining the advantages of the POCA, would also offer the greater functionality of a mainstream bank account. The DWP has so far released just the preliminary findings of its pilots and we will watch its full conclusions with great interest. (Paragraph 91)
9. Also, although it is accepted that an alternative is likely to be less profitable to Royal Mail Group than the POCA, we still do not know what impact it would have on the income of sub-postmasters. Indeed, an alternative offering with more functions, such as an ability to make deposits, might increase their income directly or indirectly, through greater footfall. (Paragraph 92)
10. The perceived financial benefit for the taxpayer from DWP's ending of the POCA is questionable if revenues for Post Office branches continue to be found from the public purse in the form of increased subsidy payments to keep the network afloat—always assuming that the size of the current network be maintained. (Paragraph 45)

Post Office Network

11. The rapid pace of change throughout financial services presents unavoidable challenges for Post Office Ltd. It is almost inevitable that Post Office branch incomes will fall over the coming years as customers become more financially aware and naturally graduate to bank accounts (including internet banking), which can offer them greater functionality, such as bill payment. We regret that Government policy is accelerating this process. (Paragraph 68)
12. With the reduction in income for Post Office branches from the termination of the POCA, coupled with a fall in income from other sources, we are very worried about the future of the Post Office network as it stands today. We are especially concerned about the impact on commercially unviable parts of the network and the implications Post Office branch closures would have on their wider communities. (Paragraph 69)
13. If the Post Office network were just a commercial entity, it would not deserve to be supported by Government. However, it fulfils a wider community need. In many places Post Office branches serve as the heart of the community. (Paragraph 73)
14. Some Post Office branches, especially those in rural areas, will always remain unviable. We believe that it is vital that across the whole of Government there is a clear recognition of the role that Post Offices play in delivering Government objectives in the community. Decisions are needed by the Government now to plan the Post Office network for the future, taking into account postal services and the wider social functions provided by Post Offices in local communities. If the Government fails to act, the network and all the benefits it provides for communities could be lost forever. (Paragraph 74)
15. The Government is rightly concerned about financial exclusion. This is not just a question of encouraging participation in banking services, it is about access in some areas to the most basic of banking services: access to cash. The Post Office is often the only outlet offering free access to cash for people in deprived areas, be they urban or rural. For many their Post Office branch provides access to vital services, such as bill payments. We welcome the Government's agreement to make social network payments for the next two years. However, we recommend that the Government should now commit itself in principle to making social network payments for the period post 2008. This would reduce the anxiety currently felt by many customers and sub-postmasters. (Paragraph 78)
16. The Government has agreed to consult with regards to any decision it takes on the Social Network for the post 2008 period. We will watch with interest the form and outcome of such consultation, which must be conducted in the most open and thorough manner and with a reasonable period for interested parties to respond. (Paragraph 67)
17. Historically the UK has enjoyed the benefits of a comprehensive network of sub-Post Offices, often in very remote, rural locations, because of the wide range of services the Government chose to deliver through those Post Offices. On top of unavoidable technological and social change, which have reduced client footfall, the Government

is now withdrawing services from the Post Offices. If the country wants a comprehensive network of Post Offices to continue, a more explicit funding mechanism must be put in place, together with product diversification and a replacement for the Post Office Card Account. (Paragraph 97)

18. There has been a lack of joined-up thinking between Government departments, perhaps to be addressed, at last, by the Cabinet sub-committee. The DWP is undermining the Post Office network by removing the Post Office Card Account, although the Government now appears to be considering the need for a substitute. The end of the Post Office Card Account has been the most serious but not the only cause of the present difficulties, as decisions by the BBC and the DVLA (with respect to licensing) have also removed income from Post Offices. Given that the DTI then have to put money in to keep the network going, taxpayers' money is going round in a circle, while there is a climate of uncertainty for sub-postmasters. This makes no sense to us. (Paragraph 98)
19. We are seriously concerned about the apparent lack of urgency in the remit given to the Cabinet sub-committee examining the future of the Post Office network. Sub-Post Offices have already lost sources of income, and postmasters will be making decisions now on whether they can sustain their business. There is a danger of seeing considerable closures before the Social Network Payment ends, unless postmasters are given a much better indication of future sources of income after 2008. (Paragraph 99)
20. There appears to be widespread, if reluctant, acceptance among our witnesses that a network of 14,500 branches is unsustainable. Postcomm has said that a network of 4,000 Post Offices could breach the universal service obligation. We expect the Government to work with Royal Mail Group and the regulator to determine the size and shape of a network that would meet the universal service obligation. Once this is done, if some individual Post Offices which are judged to provide a valuable social service are still incapable of making a profit, then the Government should be prepared to continue a subsidy to parts of the network post 2008. It should make this commitment as a matter of urgency. (Paragraph 100)

Formal minutes

Tuesday 24 October 2006

Members present:

Mr Peter Luff, in the Chair

Roger Berry	Mr Mark Hunter
Mr Brian Binley	Rob Marris
Mr Peter Bone	Mr Mike Weir
Mr Michael Clapham	Mr Anthony Wright
Mrs Claire Curtis-Thomas	

The Committee considered this matter.

Draft Report (Royal Mail Group), proposed by the Chairman, brought up and read.

Ordered, That the Chairman's draft Report be read a second time, paragraph by paragraph.

Paragraphs 1 to 100 read and agreed to.

Summary agreed to.

Resolved, That the Report be the Ninth Report of the Committee to the House.

Ordered, That embargoed copies of the Report be made available in accordance with the provisions of Standing Order No. 134.

Ordered, That the Appendices to the Minutes of Evidence taken before the Committee be reported to the House.

[Adjourned till Monday 30 October at 3.30pm]

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Mr Billy Hayes, Mr Andy Furey and Mr Jeremy Baugh, Communication Workers Union	Ev 10
Jim Fitzpatrick, Under-Secretary of State for Employment Relations and Postal Services, Ms Elizabeth Baker and Mr Stephen Lovegrove, Department of Trade and Industry	Ev 15
Mr Colin Baker, Mr John Peberdy and Mrs Sally Reeves, National Federation of SubPostmasters	Ev 25

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