

OFFICIAL SENSITIVE: COMMERCIAL; SUBJECT TO LEGAL PRIVILEGEDepartment for
Business, Energy
& Industrial Strategy

Date: 12 August 2019

Director General: Sarah Munby (Rachel Merelie covering)

Lead Officials: Eleanor Beal / Beth White (DD)

Lead Officials Telephone: GRO

Recipient	To Note / Comment	To Approve / Decide
Kelly Tolhurst		X
Permanent Secretary	X	

OFFICIAL SENSITIVE AND SUBJECT TO LEGAL PRIVILEGE**POST OFFICE BONUSES****Summary**

- As you will recall, you and the Permanent Secretary agreed that the payment of 2018/19 bonuses to those who have overseen the litigation should be reduced to reflect developments with the GLO in this financial year. The Permanent Secretary provided this steer to Tim Parker (POL Chair) and Ken McCall (Chair of POL REMCO) and they have since provided proposed approaches to reducing 18/19 bonuses, as well as reflecting the legal and organisational risks associated with these.
- POL's latest proposal is that instead of seeking to make reductions to Group Executive (GE) bonuses in 18/19, POL would concentrate on looking to impose the financial cost to management in this or in the next financial year when the financial provision for the GLO will be quantified and explicit. The final decision on 18/19 bonus payments rests with POL and we therefore recommend that the Permanent Secretary: (1) reiterate the principles the Department wants to see reflected in POL's final decision; and (2) discusses with Tim and Ken how they intend to achieve this. The recommendation in this submission has been agreed with the Acting Permanent Secretary.

Timing

- Urgent. We would welcome your input by 13 August to enable the Permanent Secretary to engage POL on 14 August. A timely response is needed to resolve this important matter and to allow the finalisation of POL's 18/19 Annual Accounts for early September.

Recommendation

- We **recommend** that the Permanent Secretary respond to POL's latest proposal regarding potential reduction to Group Executive (GE) bonuses for 18/19 affirming that the final decision on GE bonuses should rest with POL, but outlining the principles that BEIS would expect to see reflected in their final decision and reiterating some of the points made in the Permanent Secretary's initial steer on this issue (see Annex A). These principles are:
 - We expect POL to have reflected the negative developments with the GLO that have occurred in 2018/19 in the calculation of its proposed package of benefit payments to the GE in 18/19;
 - We remain of the view that as a point of principle a meaningful reduction should be made to 18/19 GE bonuses, on the above basis. However, we acknowledge that the nature and magnitude of such reductions will need to take account of legal risk;
 - We expect POL to consider the basis for 19/20 GE bonuses at an early stage, to ensure that REMCO have full flexibility to take account of wider factors, as appropriate, as they develop the final bonus offer for 19/20.

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5. If you agree this recommendation, we will advise the Permanent Secretary to respond to Ken and Tim's latest proposal on this basis and recommend that he speak with Ken and Tim to discuss their proposed next steps.

Advice

6. In consideration of the Common Issues judgement and in light of the ongoing litigation, you and the Permanent Secretary agreed that the payment of 2018/19 bonuses to those who have overseen the litigation should reflect the negative developments with the litigation in this financial year. While Shareholder approval is not legally required in this instance, the payment of bonuses should take into account of the wider context for the bonus payments in question. In particular: reports of postmasters struggling due to falling remuneration as well as the criticisms levied at POL in relation to the Company's culture, treatment of postmasters and the handling of the litigation cases by the previous legal team, whose conduct of the case has been supervised by the Board and the Executive
7. The Permanent Secretary provided this steer to Ken McCall and Tim Parker and, as set out in paragraphs 14-16, their latest proposal is to refrain from reducing the 18/19 bonuses. Ultimately, this is a decision for POL. The risks associated with reducing 18/19 bonuses identified by POL are primarily:
 - a) Legal challenge, either individually or through a class action, from those members of the GE whose bonuses are affected. POL's latest legal advice considers the legal and other associated risks with making reductions to either the STIP or LTIP for the GE population to be "high" and the impact is high both in terms of public relations, employee relations with those affected employees and potential litigation costs." The legal advice further highlights that when focusing on the issue of prospects of a legal challenge succeeding the risk profile between a reduction in the STIP and LTIP differs, with the prospects of success for a STIP reduction being medium-high and the prospects of success for a LTIP reduction being high.
 - b) Resignations from the Executive Team, which would be in the context of the arrival of a new CEO and in addition to the four members of the GE who have either left this year or are in the process of leaving: Paula Vennells, Jane MacLeod, Rob Houghton and Mo Kang. Al Cameron's position also remains uncertain, but as the Minister is aware this is due to factors beyond the current bonus issue.
8. We recommend that the Department take these risks seriously, although note that it is difficult to estimate the likelihood that they will materialise. In light of the risks and POL's ultimate operational responsibility for bonus payments, we recommend that the Department takes the approach outlined above.

Alternative approach

9. **Accept the original proposal for 18/19 bonuses and advise POL to reduce bonuses in 19/20 (POL's preferred approach).** POL's latest proposal suggests that reductions to bonuses instead be made in 2019/20. This would allow REMCO to ensure that the structure of the bonus policy allows for this. However, first, those who remain eligible for bonuses in 2019/20 will not include Executives who had oversight of POL's litigation strategy, including Paula Vennells (former CEO) and Jane MacLeod (former Head of Legal). Second, if the GE were aware that their bonuses might be impacted in 2019/20, morale and trust may be reduced and the likelihood of resignations may increase.

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Background

10. On 23 July BEIS received notification via UKGI of POL's proposed bonuses to their Group Executive and its large number of senior managers (approx. 1,400 staff). On 29 July, the Permanent Secretary wrote to Tim Parker, followed by a telephone call on 30 July, where he made it clear that in light of the judgement from the ongoing GLO litigation, he would expect POL to reconsider the level of the discretionary bonuses paid to the GE. The Permanent Secretary noted that those below the GE, who therefore were not in a position to influence the litigation, should not have their bonuses impacted.
11. On 31 July, Tim Parker and Ken McCall emailed the Permanent Secretary with an updated proposal. In summary:
 - a) No changes to the bonuses provided to the senior managers below the GE, due to over 1,400 staff;
 - b) Recommended making no reductions to the proposed bonuses in 18/19 for the GE as POL's preferred approach, but indicated their willingness to reduce payment in 2019/20;
 - c) Suggested an alternative approach, notwithstanding the legal risks identified by their legal advisers, to reducing 18/19 bonuses, if that was still BEIS's preferred approach:
 - A 10% reduction in the Group Executive's Short-term Incentive Plan (STIP) award;
 - A 30% reduction in the Group Executive's Long-term Incentive Plan (LTIP) award.
12. Following legal advice, officials noted to the Permanent Secretary that POL had not adequately reflected the risks associated with the revised proposal, as the likelihood of challenge by the affected individuals was considered to be high and legal advice was that this challenge would be very likely to be successful.
13. On 2 August, the Acting Permanent Secretary responded to the 31 July proposal. She: (1) confirmed that she was content for POL to proceed with the STIP payments for all eligible employees outside of the GE; (2) confirmed that she would agree the proposed approach to reducing 18/19 bonuses, provided that REMCO could satisfy itself that the underlying associated legal risks were acceptable to POL; and (3) asked that, if on reflection this was not the case then we would expect a further proposal for reductions to GE awards for 18/19 to be put forward which takes account of the significant concerns raised by Alex.

Latest proposal

14. On 8 August, POL responded (see Annex B). Following the receipt of further Legal Advice (see Annex C), Tim and Ken proposed that "Instead of seeking to make reductions to GE bonuses in 18/19, we would concentrate our focus on looking to impose the financial cost to management in this or in the next financial year when the financial provision for the GLO will be quantified and explicit. If any other course of action is taken, **the Post Office would be creating a high risk of claims from its GE members and incurring the costs associated with defending such claims. We would also run the risk of destabilising the GE at a crucial time.**"
15. Their response also noted that:
 - a) POL's Group HR director had resigned, citing the degree of intervention by the Department and onerous level of information requirements to support

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decisions within the business. The latest request to reduce bonuses had been the cause of his decision being taken now;

- b) Al Cameron had indicated that another member of the GE was intending to resign and suggested that the GE may well litigate as a group if there are bonus reductions.

Next steps

- 16. Permanent Secretary to respond to POL's latest proposal, reflecting the approach recommended above and discuss this steer with Ken and Tim (likely 14 August).

Contributors

- 17. This advice has been reviewed by BEIS and UKGI Legal colleagues, Jane Corera and Lucie Lambert, respectively. It does not have parliamentary handling implications.

Annexes

- A. Permanent Secretary's letter to the shareholder representative (Tom Cooper);
- B. Latest proposal from POL;
- C. Latest Legal Advice to POL from Pinsent Masons.

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Annex B: Latest proposal from POL

Sent on behalf of Ken McCall and Tim Parker

Dear Sarah

Post Office bonus awards 2018/19

Thank you for your email of 2 August 2019.

Thank you in particular for your support to our proposals to award bonuses to all eligible employees outside of the Group Executive.

In relation to the thought we have been giving to exercising our discretion to reduce GE Bonuses for 18/19 there have been a number of developments that have a bearing on any decision we may take.

Firstly, our Group HR director, Mo Kang has resigned. He has been considering this for some months, largely he tells us, as a result of the degree of intervention by the Department, and the onerous level of information requirements to support decisions within the business. The latest request to reduce bonuses (and he would acknowledge that he is affected by this) has been the cause of his decision being taken now.

Secondly we have also received a message from Al Cameron, the interim CEO, indicating that another member of the GE is intending to resign, and also the suggestion that the GE may well litigate as a group if there are bonus reductions. It is clear to us, that there is a very strong sense of feeling around the proposed reduction to bonus payments in 18/19, and we run some risk of resignations and management instability at the top of the business, at a time when there is need for continuity pending the arrival of the new CEO.

Thirdly, as we said in our original note, although the GE bonuses (LTIP and STIP) are discretionary, there is always some risk that an employee could successfully argue that they have become contractual or contain contractual elements and that not paying or reducing bonus amounts to a breach of contract. One key consequence of an argument like this succeeding might be that key GE members could leave Post Office and argue that they are not bound by any contractual restrictions such as their non-compete or non-solicitation covenants (preventing them from taking up immediate employment with competitors or from encouraging key personnel from leaving with them).

In light of the above, it is our view that we should reconsider making reductions to GE bonuses in the 18/19 financial year. Although we understand entirely the motive for wanting to share some of the impact of the GLO with those in charge in financial year 18/19, quite apart from the high risk of legal challenge, reducing bonus carries with it some very real risks in terms of the retention of key personnel, the stability of the business and the protection of the Company's commercial interests.

Instead of seeking to make reductions to GE bonuses in 18/19, we would concentrate our focus on looking to impose the financial cost to management in this or in the next financial year when the financial provision for the GLO will be quantified and explicit.

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If any other course of action is taken, the Post Office would be creating a high risk of claims from its GE members and incurring the costs associated with defending such claims. We would also run the risk of destabilising the GE at a crucial time.

As we pointed out in our note dated 31st July, decisions of this kind are difficult and there is a balance to strike between a desire to acknowledge a corporate issue, and the need to motivate and retain the key people who are currently tasked with dealing with the litigation and running the business going forward. To reiterate, maintaining the stability of the management team is particularly important for the Company as the current leadership team has been in place for only a relatively short period and that are about to be led by a new CEO, yet to join.

If it is decided that further consideration should be given to reducing GE Bonuses it would be the intention of the chairman to speak to each GE member to explain the rationale for this before proceeding with this course of action.

We can make ourselves available at the earliest opportunity to discuss this further with you.

We look forward to hearing from you.

Yours sincerely

TP and KM