BEIS0000983

UK Government Investments

Department for Business, Energy & Industrial Strategy

OFFICIAL-SENSITIVE: COMMERCIAL/ PERSONAL
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Recipient	To Note / Comment	To Approve / Decide
Permanent Secretary	X	
Minister Hunt	X	

Post Office Limited (POL): Quarterly update

Summary

1. This quarterly update is for your information.

Timing

2. Routine. Officials held the POL Quarterly Shareholder Meeting on Tuesday 5 July and this update includes the most current position.

Overview

3. Litigation remains a key challenge, but good progress has been made:
    - The Historical Shortfall Scheme (HSS) has now issued 73% of offers and is on track to meet the target of 80% of offers made by the end of August.
    - Overturned Historical Convictions (OHC) on 29 July, POL received the outcome of the Early Neutral Evaluation process (ENE) regarding non-pecuniary heads of loss. This set clear financial precedents and we expect POL to make offers to the 10 claimants shortly.
    - Suspension pay compensation: PIC is yet to make a final decision on this, nearly two months after receiving the business case POL is increasingly frustrated at the delay
    - Other PM Detriment: POL has identified additional areas of Postmaster Detriment where it may have breached the Common Issues Judgment (CIJ). It is developing a plan to address the potential liability which is expected shortly.
    - Group Litigation Order (GLO): Interim payments totalling £19.5m were announced on 30 June and the first payments have now been made. The GLO group will be informally consulted on delivery options before we take the business case to PIC later this year.

4. Financial and governance matters have progressed well, but cost pressures are increasing
    - The Spending Review (SR) process concluded with the Funding Agreement and Working Capital Facility now signed. The FY22/23 budget has now been approved, subject to UKGI being satisfied with POL's Investment Spend reporting. Discussions are ongoing.
    - As at end June 2022, POL are ahead on trading profit with £14m vs £2.6m budget. Investment Spend is tracking c.£5.5m below budget for the same period. However, mails revenues continue to underperform. A new 3 year plan is being prepared which is likely to show POL will be under significant financial pressure through the rest of the SR period. Postmasters are continuing to lobby for better remuneration as a result of cost pressures.
    - Network performance remains above the policy target at 11,600 branches.
    - Recruitment of the new Chair is being progressed, with the preferred candidate with No 10 for approval. We are also considering interim chair options. Succession planning remains a key risk at all levels across POL.
    - POL's RemCo has approved the outturn for the Transformation Incentive Scheme but other remuneration schemes remain outstanding. Executive pay at the company in

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FY21/22 may attract public comment and we have advised POL to consult the Permanent Secretary.

- POL have continued to deliver their culture improvement programme and improvements have been seen in their annual engagement survey but overall it remains low.
- POL are working through issues with the Horizon replacement programme which is returning to BEIS PIC in September (delayed from August)

Legal [Subject to Legal Privilege]

5. Historical Shortfall Scheme (HSS)

As of 8 August 2022, POL has made 1,758 offers to a value of £49m, representing 73% of eligible claims, and met the end of July target. 1,378 offers paid (£24m). POL is on track to meet the next major milestone of 80% of offers to be made by the end of August 2022.

POL, in consultation with UKGI and BEIS, has finalised its multi-stage Dispute Resolution Process (DRP). The DRP has been operating effectively to date, with only 7% of responses in dispute. Should cases reach the latter stages of the DRP, officials have agreed a test case process with a view to delegating authority once BEIS is comfortable. In line with comments made at the recent Inquiry hearings, we are looking to agree additional legal and professional fee support to the claimants in the DRP, with a cap of £5k-£10k per claimant depending on the case complexity.

We expect POL to submit its proposed approach to dealing with late HSS applicants (c.200-500 potential cases) shortly. UKGI and BEIS officials are working with HMT to agree funding arrangements and delivery principles, and will submit the proposal for Perm Sec / Ministerial approval once it has completed governance. Given the focus of the Inquiry on this issue, POL regards securing funding as a major priority and is likely to escalate this issue to you and/or Ministers in the event it is delayed.

Working with their auditors, PwC, POL is preparing an update to the provisions for the March 2022 annual accounts, which should be signed this month.

6. Overturned Historical Convictions (OHC) & compensation.

81 convictions have now been overturned. POL has received 76 interim payment applications, 71 offers have been made and 70 offers accepted, worth £7.0m.

Substantial progress has been made with the first two 'pilot' cases with one claimant agreeing to settle their pecuniary claim, and the other part settling their pecuniary claim and agree to mediation for the outstanding Head of Loss. Payments have been made to both of these claimants in relation to the settled elements of their claims.

To settle the non-pecuniary elements of the claims, POL and claimants agreed to an Early Neutral Evaluation process (ENE) led by Lord Dyson, a retired High Court judge Lord Dyson has reviewed 10 cases and provided his view on the appropriate range of each non-pecuniary Head of Loss and suggested where each of the 10 claims sit on those ranges. Both POL and BEIS officials are broadly happy with Lord Dyson's evaluation. POL is working to develop meaningful offers ahead of a meeting between POL and the claimants' representatives on 11 August. The ENE process should also help set precedents to settle non-pecuniary claims more quickly as soon as claims are received, and we intend to provide further substantive advice on next steps in the coming weeks. We are pressing POL to make offers as soon as possible, including on exemplary damages (where Lord Dyson said that each claimant should receive £75k).

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POL has continued to make good progress on contacting potential further appellants with the support of the CCRC. Out of the 706 criminal convictions prosecuted by POL, POL has been able to contact 665 individuals and are conducting extended tracing to contact the other 41. POL has been supporting other prosecuting bodies in providing disclosure and facilitating engagement to progress other potential appeals However, it is clear other prosecuting bodies have not made as much progress as POL. POL have also undertaken a pilot to better identify clear Horizon cases and notify those individuals that it wouldn't stand in the way of their convictions being overturned.

7. <u>Postmaster Detriment</u>.
The business case for the suspension pay issue went to PIC on 9 June. POL is frustrated that the Committee did not give approval until 9 August because it requested further information on some detailed PSED questions. HMG's responsiveness is an area of vulnerability in relation to the claimants affected, the media, and the Inquiry.

The preferred option in the business case costs up to c£98m and will require discussion with HMT via a TAP process now that we have a final decision from PIC. You will receive advice on this shortly. We have agreed with POL that they will procure independent assurance through their internal audit function to meet BEIS assurance requirements. This assurance includes project set up and the delivery of the compensation process including the live review of initial cases and exceptional cases prior to approval.

POL has identified additional areas of Postmaster Detriment where it may have breached the Common Issues Judgment (CIJ) These include 77 current Postmasters who are still paying off debts from shortfalls (from the new version of Horizon) which POL did not investigate, contrary to the CIJ. Officials have encouraged POL to find a way to deal with the remaining detriment issues, including Postmasters who are repaying balances. Legal Privilege Legal Privilege Legal Privilege We have asked POL to investigate the issue of the unpaid shortfalls with affected Postmasters with the cover of their letter of comfort before requesting funding if needed.

8. <u>GLO.</u>
In March 2022 the Chancellor announced further funding to deliver compensation to the GLO group. HMT have made £80m from the Reserve available for this compensation, subject to BEIS first making underspends available In June 2022, Minister Scully announced Government would make an interim payment of compensation to eligible Postmasters while the full scheme was being developed, totalling £19.5m. Payments have now been made to the first batch of GLO claimants.

BEIS have contracted with Freeths, the lawyers who represented the Postmasters in the 2019 litigation, to gain access to their data and insights into the methodology they used Officials held a very successful two-day workshop with Freeths and representatives from the Justice for Sub-Postmasters Alliance in July 2022 to work up a delivery option for the full compensation scheme.

In September (subject to Ministerial views), BEIS will informally consult the GLO group on options for delivering the scheme. We will talk to their lawyers this month. The options include different approaches to delivery by POL or BEIS. We will use the feedback to inform work on the business case, which we hope to take through PIC in October.

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Financial and Operational Performance

9. Spending Review, budget & legal costs control.
During the last quarter the final elements of the Spending Review (SR) process and settlement were concluded, with the updated Working Capital Facility (WCF) signed in early July, following the late April execution of the Funding Agreement.

POL provided a FY22/23 budget for review in May and, following scrutiny, this was conditionally approved on 22 June. The conditionality relates to the level of information provided by POL in their regular Investment Spend reporting – UKGI have been engaging with POL on the details of this and progress is being made. An update and confirmation of when a satisfactory position has been reached will be provided in the next 2 months, ahead of the next HMG funding to be paid to POL.

The FY21/22 Annual Report and Accounts (ARA) are being finalised and expect to be signed by mid-August 2022. They are expected to be laid in Parliament and published later in the year.

10. Trading update.
As at Period 3 (capturing to end June), POL are tracking ahead on trading profit, with a YTD total of £14m vs £2.6m per budget. This largely reflects strong travel performance with particular benefit to the Insurance and Travel Money business lines. Banking continued to perform strongly delivering c.£60.1m YTD revenue vs c.£58.7m budget. Mails continues to lag behind budget on a YTD basis (£79.1m actual vs £80.8m budget) with underperformance vs budget in the Labels and International lines continuing recent weakness in these areas, and suggesting some risks to full year projections. More detail is in **Annex A**.

POL received positive press coverage on 8 August for its latest data about cash usage, with branches handling a record £801m in personal cash withdrawals in July, marking an increase of nearly 8 per cent month on month. Cash deposits have also been strong.

11. Investment spending.
Investment spend for Year to Date to P3 is tracking c.IRRELEVANT below budget (spend of IRRELEVANT vs budget of IRRELEVANT) largely due to delays and deferrals of key projects, particularly within IT and Business Transformation. Across the full year, material risks to investment spending remain, with a significant concentration of spend value among Horizon replacement, Belfast Exit and Historic Matters legal costs – all of which have been subject to some level cost escalation risk. The team are monitoring the situation closely and – as noted in the conditionality around the 22/23 Budget Approval – working with POL to ensure optimal monitoring information is received to aid early identification and response to risks.

The latest P3 forecast for Belfast Exit anticipates project spend to be IRRELEVANT above budget for the year (IRRELEVANT), driven by significant delays and technology issues. An update presented at the July POL Board projected lifetime costs of c. IRRELEVANT for Belfast Exit as a result of these issues, a substantial increase from the c. IRRELEVANT forecast presented to the March POL Board. A paper on proposed solutions with financial implications is expected at the September POL Board.

The latest three year plan forecast is IRRELEVANT vs plan of IRRELEVANT, an increase of IRRELEVANT. The original plan of IRRELEVANT was outside the affordability envelope by c. IRRELEVANT, with the main drivers for this as above. POL is currently developing a 3 year business plan to bring to the September POL Board which is expected to outline how this will be managed.

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12. Network performance and sustainability.
As at the end of June the Network stood at 11,600, which is 100 branches above the policy target. More detail is in **Annex B**.

Governance

13. POL Board strategy and policy review.
The POL Board met for a strategy day in July and the new Minister, Jane Hunt, attended. The Board discussed the objectives of the BEIS policy review and POL's engagement strategy. The Board also considered POL's Mails strategy, strategic commercial considerations, the long-term drivers of future network shape, and plans to build a resilient network equipped for the decade ahead. Key areas of consideration included the following
- POL is exploring opportunities to expand its offering with other parcels carriers. It already has relationships with Amazon and DPD
- POL also intends to digitise customer journeys to allow customers to buy services online
- POL is developing a target operating model and its views on the ideal shape of the network. The size of the network could be reduced while still meeting geographical targets. This could improve longer term profitability, however, closing branches costs money in the short term. POL is still developing its plan to reach its target operating model.

The BEIS policy team are pressing on with the POL Policy review, on an internal basis.

14. Chair appointment and succession planning (SENSITIVE – PERSONAL).
UKGI successfully progressed the POL Chair recruitment despite initial delays obtaining approvals impacting the timetable. The SoS's preferred candidate has been submitted to No 10 for approval, and we are also progressing interim Chair options. UKGI is working with POL to design a comprehensive induction programme for the new Chair. An exit interview has been organised for the current Chair with the Perm Sec on 13 September.

The terms of two POL NEDs are due to expire in the next 8 months. POL submitted a request seeking an extension to Zarin Patel's (Senior Independent Director) term by 3 months and Lisa Harrington's (RemCo Chair) term by 5 months to support continuity and the transition to the new Chair. The extension requests were approved by Minister Scully and the SoS. Approval to launch the campaign for the replacements of Zarin, Lisa, as well as Carla Stent (ARC Chair), who's exceptional third term appointment will end in January 2024, will be sought shortly once POL finalises their recruitment campaign strategy

The immediate flight risk issues with the CEO and CFO have reduced However, there is an ongoing need to develop succession plans at senior levels. There are no immediate successors for CEO and CFO in post, and the non-executive directors have continued to press for better planning in this area

15. Remuneration.
POL's RemCo has approved the outturn for the Transformation Incentive Scheme (the proxy replacement for STIP 20-21 which was withdrawn due to the pandemic) and LTIP 2019-22. However, the outturn for STIP 21/22 still needs to be agreed. Performance outturn against metrics for STIP 21/22 has now been approved, but POL wants to introduce a new individual performance multiplier which would require governance approvals from RemCo, BEIS and HMT.

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RemCo approval of performance metrics for LTIP 21-24, STIP 22/23 and LTIP 22-25 are still outstanding. The main remaining issue is the way to set effective targets for trading profit and Investment Spend.

The appointment of the new Chair will beach the current £400k Board pay cap in the Articles of Association, as the current Chair waives his fees. You will shortly receive a request to increase this.

16. Postmaster culture change.
The Second POL Annual Research survey shows an overall increase in Postmaster sentiment, but it remains low at 28%. On two specific metrics improvements have been made by 8 percentage point uplift on describing relationship and 6 percentage point uplift on how supported Postmasters feel. Whilst the level of Postmaster Satisfaction is disappointingly low, these improvements are seen as a result of the work POL has been doing on the feedback from previous surveys. It has updated the action plan quarterly to ensure all directorates are focused on delivering key tangible actions to support Postmasters, as a result of their feedback from the survey. It has also successfully introduced WhatsApp groups to improve Area Manager communications, and there has been successful engagement through the Regional Forums and the Voice of Postmasters to identify opportunities for continuous improvement.

Remuneration remains the biggest issue for Postmasters who are continuing to lobby for better remuneration as a result of the cost pressures they are facing. POL are considering potential options to address some aspects of remuneration issues. The introduction of the Horizon replacement is seen as key risk for the Postmaster relationship. Whilst Horizon has been the source of problems historically, Postmasters are now familiar with it and there is anxiety over a new system. Therefore, a pilot approach is being taken to increase confidence in the new system and demonstrate its useability and robustness prior to wider roll-out.

Project delivery

17. Strategic Platform Modernisation Programme (SPMP) / New Branch IT (NBIT).
POL have opened 10 Drop & Collect (D&C) branches that work without Horizon, which is much less than the planned 500, although POL consider they have the potential for over 1,000 by 2025. POL has also extended their services to include Royal Mail Collections and Parcelforce Returns/Collections products. Volumes are approaching 400 non-Horizon transactions weekly. Any large expansion of the D&C format could be unpopular with existing Postmasters who fear cannibalisation of their mails business. The pilots are exploring this issue.

The Full Counter Pilot planned for September has been scaled back following delays in the operating system decision and the move from Android to Windows. Release 1 in September will now be focused on a more limited set of products. There are three other main risks and issues

- The lack of clear path to leveraging existing Payzone capability for the development of legacy pre-paid bill payment solutions, which drives a need to build a whole new solution.
- The delays by Ingenico/Worldpay in supporting the Payments stream of NBIT, which has delayed POL's ability to test end-to-end product journeys (i.e., including payment from the customer).
- The ongoing discussion regarding whether POL should stop offering the National Lottery and instead allow Postmasters to contract with Allwyn (the new Lottery provider) directly.

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POL is working through these and will shortly have completed a revised high-level plan, with the detailed version in September. The working assumption for the delay is 3-6 months, or a delivery timetable towards the end of 2024. With this expected delay it is increasingly likely that POL will have to extend Fujitsu services from March 2024 to March 2025, but this is a hard deadline as Fujitsu have been clear that the contract won't be extended again.

POL is preparing for PIC on 8 September, delayed from August because of keyholder feedback. This meeting will inform conversations on the appropriate timing for a gateway review which is more focused on delivery and readiness for roll-out. We will work with POL to ensure they are ready, and are working to engage with keyholders ahead of the meeting.

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Annex A: Financial performance

Financial performance forFY22/23 (Year to Date – until Period 3: End-June):

	Actual (£m)	Budget (£m)	% var to Budget	% var to 20/21
Total Revenue	**212.1**	**206.8**	**3%**	**7%**
Cost of Sales	(11.7)	(10.9)	(7%)	(5%)
PM Remuneration	(98.1)	(97.0)	(1%)	3%
Staff Costs	(42.5)	(42.5)	0%	1%
Non-Staff Costs	(54.6)	(56.9)	4%	25%
FRES	8.3	2.6	219%	429%
Other Income	0.6	0.4	50%	322%
Trading Profit/(Loss)	**14.0**	**2.6**	**442%**	**213%**

Latest outlook

Year to date performance has been positive, with upside in travel particularly helpful and a one off profit share payment in Home Insurance(£2.6m vs £1.1m budgeted). Under-performance in Labels and International within Mails balances some of this upside and creates risk across the full year outlook because of how material Mails is to overall performance – this will be monitored closely.

Revenue

Revenue exceeded the YTD budget (£148.4m vs £143.5m) driven primarily by the buoyant travel market with Insurance and Travel Money segment contributing c£2.4m and £1.2m revenue upside respectively.

Costs

Staff costs and non-staff costs have tracked closely to budget in the year to date (within c.1%) while Postmaster Remuneration has slightly exceeded budget, largely as a consequence of the outperformance of revenue vs budget driving a correlate rise in PM remuneration.

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Annex B: Network access criteria and branch numbers

Performance Against Access Criteria at the end of June 2022

Criteria	Number of branches	Total Population within 3 miles	Total Population within 1 mile	Deprived Urban Population within 1 mile	Urban Population within 1 mile	Rural Population within 3 miles	Postcode Districts less than 95% Population within 6 miles
Target	11,500	99%	90%	99%	95%	95%	0
June 2022	11,600	99.6%	92.6%	99.4%	97.8%	98%	7[1]

Branch numbers at the end of June 2022

Type	Mains	Local	DMB	Traditional	Outreach	Drop and Collect	Total
Number	3,355	4,233	117	1,968	1,907	20	11,600

[1] The Postcode District (PCD) accessibility can be impacted by one or more branches not providing service at the time of reporting. Since March 2020, this access criteria was affected by 7 Postcode Districts.