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Department for
Business, Energy
& Industrial Strategy

Date: April 2018

Director General: Mark Russell

Lead Official: Richard Callard

Lead Official Telephone: GRO

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

POST OFFICE – LITIGATION RE HORIZON IT SYSTEM**Summary**

1. To notify and update you about the civil litigation being undertaken against Post Office Limited (POL) in relation to historic claims about the Horizon IT system and ongoing work to manage the risk and ensure that you, the Department and UKGI have sufficient oversight while protecting POL's legal privilege in its defence against the litigation.

Timing

2. Routine. This is not a new issue but an update is timely as both parties work towards the first case hearings in November this year and UKGI is developing with POL an information sharing protocol that balances oversight requirements with legal privilege concerns. We will submit the protocol for your approval in due course.

Recommendations

3. That you note the issues, risks and next steps set out below.

AdviceBackground

4. Transactions at the post office counter are undertaken on the Horizon system, which is used by c50,000 people per day across the network, and which POL estimates has been used by around half a million employees (at Crown branches), agents or employees of agents since it was introduced in 1999.
5. In 2012 a small number of (mostly former) subpostmasters, under the banner of the "Justice for Subpostmasters Alliance" (JFSA) and with support from some MPs led by then-MP James Arbuthnot, claimed POL's Horizon IT system had caused accounting losses (shortfalls in physical cash against cash holdings recorded on Horizon) which they had had to make good. In some cases they had been prosecuted for these losses (usually for false accounting or theft or both) while, in other cases, they claim that it led to bankruptcy or consequential, personal losses ranging from divorce to suicide. Most of these cases, at least initially, related to issues prior to Post Office's separation from Royal Mail in 2012. Initially, the dispute revolved around whether the losses arose from human error and fraud in-branch (POL's position) or from systemic error (JFSA's position).

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6. POL and the JFSA jointly commissioned an independent firm of forensic accountants, Second Sight, to examine the system for evidence of flaws which could cause accounting discrepancies. Second Sight's initial report in June 2013 found no evidence of systemic flaws in Horizon that could cause the issues raised. A final report in 2015 did find that in some cases POL could have provided more training and support to subpostmasters. POL has since made changes to address this although the Court's view as to what is sufficient under POL's contractual relationship with subpostmasters is yet to be tested.
7. A mediation scheme was established in 2013, with JFSP involvement, to work through 136 cases, in an effort to resolve the individual disputes. This included specific forensic investigation into those cases. As before, no evidence of systemic flaws in the system was found; rather the investigations (by Second Sight and Post Office) found that the main reason for losses in the majority of cases was "errors made at the counter" by the subpostmaster or their staff. While UKGI and BEIS have always maintained that the details of individual cases are confidential between POL and the individual, we understand that the cases considered in the mediation scheme have ranged from, at one end, examples where POL could and should have provided more support to the subpostmaster in preventing errors being made, to the other end, where there has been clear incompetence, fraud or dishonesty from the subpostmaster or their staff.
8. The mediation scheme ultimately proved unsatisfactory to the JFSA and was closed in early 2015. Whilst 22 subpostmasters were able to settle their disagreements with POL, and others were able to progress their issues with POL, the JFSA was not satisfied with the outcome and continued to campaign for a better resolution. One important factor was that many JFSA members were seeking substantial sums in compensation, which was not forthcoming, and indeed some were seeking to overturn convictions for false accounting, fraud or theft (about 40 cases), which the mediation scheme could never resolve. It is worth noting that none of those convicted of an offence have appealed their conviction or their sentence, according to POL. Since the mediation scheme launched, around 20 individuals with convictions have referred cases to the Criminal Cases Review Commission (CCRC), whose review process has now been going on for around two years. BEIS/UKGI have disclosed information to the CCRC, as we are required to do by law, for their investigations. We do not know when the CCRC might form a judgement on any case, though it may decide to await the outcome of the civil litigation before passing judgement.
9. In recent years, the focus of the complaints by subpostmasters has shifted from issues with the IT system, to the alleged "unfairness" of the contract between POL and subpostmasters. Subpostmasters are agents of POL, not employees, and according to well-established guidelines under the law of agency, the agent (subpostmaster) has a fiduciary duty to account to the principal (POL). This principle is reflected in the contract between POL and subpostmasters, which requires subpostmasters to make good any losses of third party monies under their care (e.g. benefits, cash paid into bank accounts etc). This means that where there are discrepancies between cash in the safe/till compared to the cash stated by the system, and no clear reason can be identified, the subpostmaster is liable

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for the missing money. Where there is evidence of theft or false accounting, POL can (and has) sought to bring a prosecution against the individual responsible, often the subpostmaster but occasionally a member of their staff.

10. The litigants are claiming that the contract did not reflect the true nature of the POL–subpostmaster relationship. While they accept that there was a principal–agent relationship in force, they nevertheless maintain that the relationship was akin to an employment relationship and, as such, the fiduciary duty to account to the principal did not apply thereby shifting the burden of responsibility for explaining accounting losses from subpostmasters to POL. Linked to this, they are also seeking to establish that the contract implies other terms that further shift the burden of responsibility onto POL – for example, that POL had an obligation to provide sufficient training to Subpostmasters to help them avoid accounting errors.
11. There has been significant lobbying by JFSA of Parliament and through the media, although this has not altered POL’s position which is that these are individual disputes best settled between each party. Absent any further movement from POL, the JFSA announced a group civil litigation against Post Office in November 2015. There have been a number of debates in the House since 2012, POL appeared in front of the BIS Select Committee, and the issue has featured on programmes such as The One Show and Panorama. Public attention has been much reduced since the civil case was launched, except for the litigants’ solicitors advertising for further subpostmasters to come forward. There are now around 550 parties to the case – we understand from POL that there is limited commonality in the complaints and claims being put forward. Of these cases, we understand that some are likely to be dismissed by the court as they fall outside its remit: about 100 relate to criminal cases and about half fall outside the statute of limitations period, while some subpostmasters have already agreed to waive their rights to bringing further claims by leaving the Post Office network under its settlement scheme.

Measures taken by POL and UKGI

12. POL has undertaken a significant amount of work ever since the claims were first raised to establish whether there are any issues here and identify any solutions. In addition to the mediation scheme, which was entirely funded by POL, and paying for the Second Sight forensic investigation (who have increasingly forged close links with the JFSA), POL has undertaken a number of activities:
 - POL appointed Deloitte in 2013 to look at the Horizon system to establish its veracity. Whilst this was a limited study due to the passage of time, no issues were found.
 - At Baroness Neville-Rolfe’s request, POL Chair Tim Parker commissioned a new QC to investigate the matter when he joined POL in October 2015. The initial findings of this investigation satisfied the Chair that POL had taken the appropriate action at each stage. With the announcement of the group litigation in November 2015, the Chair decided following legal advice not to conclude the investigation as it could have impacted the Court’s consideration of the claims.

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- POL have spent many millions of pounds investigating individual cases and have not identified any systemic issues which could have caused these problems (rather finding a range of issues as outlined above).
13. UKGI and its forerunner ShEx have followed this issue throughout:
- UKGI has been in close touch with POL to understand how the various investigations, mediations and legal cases are progressing, although we have always avoided getting involved in the details of individual cases. We are aware of some details where individuals have discussed their cases in the press.
 - UKGI has provided numerous briefings to Ministers, and in day one briefings. The Post Office Chair and CEO have also briefed Ministers in the past and would be happy to do so again.
 - As part of his role on the Board, shareholder representative Richard Callard sat on the Board sub-committee on this matter, until this was disbanded after the mediation scheme ended.
 - ShEx/UKGI assisted the CCRC in its enquiries, disclosing files held.
 - BEIS Legal have been kept updated and held discussions with POL shortly after the last case management meeting (more details below).
14. Since the High Court proceedings for the civil litigation were issued in April 2016, the issue has been much quieter as we awaited further details and likely direction of the case, which are only now emerging. We have informed Andrew Griffiths in person of the risk, and are arranging for him to meet Post Office's General Counsel.

The Litigation

15. The case, led by Freeths Solicitors, involves around 550 current and former subpostmasters – the JFSA state the number of claimants as 561. Post Office have engaged two QCs and are being advised by Bond Dickinson.
16. At a case management meeting held in October last year, it was agreed that the first hearing ("Common Issues Trial") would be held on 5 November 2018. Both sides will each select 6 test cases, with 6 of those 12 being tested in the court, to establish what points of law should be tested for the group of litigants as a whole, particularly the question of the proper construct of the contract and what terms are implied in it. The "horizon trial" will then be held in March 2019 to look in detail at the specific issues claimed in relation to horizon across the wider set of cases within the parameters set by the first trial. The full Group Litigation Timetable is set out in Annex A.
17. In the meantime, both sides are seeking to establish the facts of the cases. The court recently opined that Freeths could make limited and relevant further requests for POL to disclose information, and POL is seeking more information on the extent of the claims, which have not been disclosed in any great detail.

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18. Until the November hearing, which will set the parameters of the case, it is hard for POL to determine with a reasonable degree of accuracy the potential level of liabilities that the business is exposed to. Although few details have been provided to them by Freeths, POL knows from its experience of the mediation scheme and other bilateral discussions with subpostmasters before this case started, that the high water mark for the quantum of the claims against them extends to c£250m. However, POL knows from the mediation scheme that these amounts include claims for loss of future earnings, school fees, reputational damage etc, which POL and its legal advisers do not consider it would be liable for even if the court found against them. To give this amount some context, the average recovery made by POL from these subpostmasters is c£XX each, equating to c£XXX if extrapolated across the 550.
19. It is worth noting that POL's auditors EY have agreed with POL's accounting treatment of this, which is not to create a provision given the lack of claim details put forward to date.
20. POL's next priority is to seek security of costs, such that they have assurance that should they win the case they can seek to recover costs from the litigants. The claimants action is being funded by a private equity firm who specialise in legal claims (who will take the first c£20million of any award should the litigants win), but POL does not currently have certainty that this firm would meet POL's costs should POL win the case. This will be considered at a "Security of Costs Hearing" on 30 April 2018 and could lead to the case being dropped if security of costs is insufficient. Whilst this would be a good result for POL legally speaking, the JFSA would likely re-engage their public campaign claiming that they had been denied the opportunity for their case to be heard in court, with the issue possibly returning to parliamentary debates and scrutiny.
21. Should the case proceed, there is clearly a risk that POL is not successful, or that recent caselaw has some impact on POL's case e.g. subpostmasters have not previously been considered to be employees, but recent cases like the Uber or Pimlico Plumbers ones may mean the duty of care between POL and subpostmasters has shifted, with further implications for the Post Office. POL periodically face separate cases whereby a subpostmaster claims that their status is that of an employee or a worker rather than an agent, and these could further complicate the litigation (or vice versa). [Post Office are currently appealing a specific case whereby a *temporary* subpostmaster successfully claimed that they were an employee]. POL was notified on 25 April that 120 subpostmasters have launched a claim that POL should be treating them as employees or workers. POL is awaiting more detail but suspects that these postmasters run smaller community branches with very limited business aside from the post office (for which they get a mix of fixed and variable remuneration).
22. [Insert POL legal adviser / QC view of the case]

Impact on POL

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23. In addition to the significant cost and distraction this has generated for POL over the last few years, other implications include:

- POL has been less rigorous in its enforcement of its contract when money goes missing. With a network of over 11500 branches it is inevitable that some individuals working in the network, including subpostmasters, are less honest or competent than the vast majority. POL has still suspended or terminated the contracts of subpostmasters where they have been found to be at fault, but has been less rigorous in its recovery of funds, focussing instead on trying to spot discrepancies as they emerge. POL is seeing the effect of this, in that there appears to be an uptick in issues of fraud (and of those accused of fraud joining the litigation proceedings, making recovery harder).
- POL has had to take greater care in the roll-out of its new Horizon equipment than would otherwise be the case, making a complex implementation all the more complicated.
- The shift of the claimant's argument from the IT system to the "unfairness" of the contract could give rise to broader debate about lack of employment or consumer protections for subpostmasters. Given that the majority (about xx) of post office branches are run by self-employed subpostmasters on an agency basis (the remainder are run by multiple retail partners like WHSmith or McColl's), an adverse ruling could force POL to reformulate contracts for new operators and renegotiate existing contracts, and, by extension, potentially impact more broadly on its operating model and commercial sustainability.

Ongoing Work and Next Steps

24. POL has established a board sub-committee to consider the issues as they arise on behalf of the board. The schedule for both the sub-committee meetings and board meetings has been synchronised to the Group Litigation Timetable (Annex A) so that POL's QCs and legal advisors can provide regular updates at critical junctures in the trial process.

25. As the case begins to progress more meaningfully, and given the financial and reputational risks it carries for POL, we wish to put in place effective oversight to ensure the risks are flagged and managed as you require. The UKGI shareholder representative sits on the board as a non-executive director and is also a member of the sub-committee. However, the ability for him to facilitate the oversight function by updating you and the Department, with the help of legal advice from UKGI and BEIS legal teams, is hampered by restrictions around legal privilege and protecting POL's legal defence. Therefore, POL and UKGI legal teams are developing an "Information Sharing Protocol" based around the Group Litigation Timetable to facilitate oversight while preserving legal privilege, which we will submit to you for approval in due course.

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26. [UKGI Legal to insert a description of protocol purpose and key features]

Contributors (*Retain the relevant sentence and identify who has provided input*)

27. This advice contains financial considerations, as agreed with [Name] / This advice does not have financial considerations, as agreed with [Name].

28. Legal [Name] has been consulted and agreed the content of this advice/ This advice is not considered to raise legal issues and Legal has not been consulted.

29. Communications considerations have been taken into account, and agreed with [Name] / This advice does not have communications implications, as agreed with [Name].

30. Parliamentary handling has been taken into account, and agreed with [SCS Name] / This advice does not have parliamentary handling implications, as agreed with [SCS Name].

Annexes

A. Group Litigation Timetable