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POST OFFICE LTD BOARD SUB COMMITTEE

Initial Complaints Review and Mediation Scheme: The way forward

1. Purpose

1.1. This paper and accompanying slide pack:

- Updates the Sub Committee on the current position and progress of the Scheme and associated risks and challenges
- Seeks agreement to a preferred approach

2. Background and current position

2.1. The rationale for change has been well articulated elsewhere and the urgency has not lessened since the Sub Committee last met. Moreover, absent any intervention by Post Office Limited, the Scheme will continue inexorably to “march on”, albeit at a fairly slow pace. The current position is that:

- Out of a total of 136 cases still in the scheme only three applicants have been provided with a Second Sight report in draft. Deadlines for comments from the parties (Post Office being a party) on those three reports are set for week ending 6 June, after which Second Sight have a further week to produce a final report which will then be considered by the Working Group. Further details on progress are in the slide pack at page 3.
- It is therefore likely that these three cases could reach mediation within the next six weeks and Post Office can only prevent that by either settling a case outside of mediation (as we are attempting to do with one case) or declining to mediate (a definite position on one of the cases, and a possible position on the other as, although mediation may provide an opportunity to discuss the Post Office position with the applicant, we would not be minded to make any financial settlement).
- Second Sight has now committed to produce three reports a week. If they meet that commitment, we can expect a further three reports this week and every week to be issued to the parties with seven days to comment. At this rate of productivity from Second Sight they will have completed their work on all cases in about a year from now, and allowing additional time for mediation, a best case and extremely optimistic scenario would be for the Scheme to complete in August 2015.
- We consider it unlikely that Second Sight will consistently produce three reports a week in draft as well as three final reports and our working assumption is that their productivity is likely to be closer to two reports a week on which basis the Scheme is likely to run until November 2015.

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- It is likely that Second Sight will recommend mediation in most, if not all, cases and JFSA is likely to agree. Where Post Office does not agree, and cannot persuade the working group not to recommend a case for mediation, the only course open to us would be to decline, as a party, to mediate. Over time such a stance is likely to create tensions within the Working Group.

3. Options

- 3.1. Against this backdrop, the programme team has developed three options for consideration by the Sub Committee:
1. Continuing with the Scheme as currently configured and managed.
 2. Continuing with the Scheme but seeking to refine its work within the existing Terms of Reference, with Post Office taking a firmer more proactive line to defend its position and ensure a greater degree of transparency around our approach to the Scheme with mediation being based on our understanding of the legal position and desire to control programme costs and timescales.
 3. Completing the Post Office investigation in each case and moving the governance and management of the Scheme in-house (ending Second Sight's engagement and dissolving the Working Group).

Option 1: Continuing with the Scheme as currently configured and managed

- 3.2. The implications of this are that:
- The administrative cost of the Scheme will reach around £12.5M at its conclusion – excluding any compensation payments.
 - The Scheme is likely to last for up to 18 months (up to November 2015). This investment of time is substantial even in the event of the Scheme delivering a high quality product.
 - We could end up with applicants and stakeholders being more dissatisfied at the end of the Scheme (having had their expectations raised as a result of the value advisors are putting on their claims)

Option 2: Continuing with the Scheme but seeking to refine its work within the existing Terms of Reference

- 3.3. Given the concerns about the current arrangements of the scheme, we have considered ways in which the business could provide greater clarity around our position, while remaining within the Terms of Reference of the Scheme. This option would entail setting out the business' view on a number of issues.
- 3.4. This option could, we believe, lead to the delivery of a Scheme which provides greater value for the business while still allowing for the prospect of a full investigation of all applicants' complaints under independent oversight. We

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estimate the whole life cost for this option at £10.7M. All measures proposed within this option would fall within the terms of reference of the Working Group.

- 3.5. It is our assessment that steps we might take (set out at 3.7 below) could place strain on the Working Group and may lead to one or more parties withdrawing from the Group. We believe we could justify our stance publicly by stressing the need for greater transparency in the interests of all applicants, and reaffirming our commitment to investigate all cases in any circumstances.
- 3.6. While our stance might attract some adverse (though manageable) PR and would require detailed stakeholder planning, we do believe the measures set out below would be accepted as reasonable in the court of public opinion.
- 3.7. This option could be implemented as follows:
 - Making it clear that Post Office will deal with criminal cases last (they take longer because of the volume of documentation and the legal clearance is more complicated and dealing with them in the bulk of other investigations slows down progress on other cases) and that we would only mediate in these cases in exceptional circumstances, believing that the correct next step for any of these applicants would be the Criminal Courts. This would impact on around 40 cases. It could be justified on the basis that such cases have been through the judicial process and steps remain open to applicants to pursue their cases through the courts.
 - Moving Second Sight to a fixed fee structure with a clear work-plan (potentially with incentives to increase the speed of work) and regular quality and delivery review meetings – potentially saving several hundred thousand pounds depending on the fee level agreed. This could be justified in the interests of value for money, particularly in the context of an approach which has now lasted for almost two years.
 - For cases which date back to pre-2007, for which records should have been destroyed under Post Office's data retention policies (as is best practice), carrying out a review of any available data to see if it supports a full investigation being taken forward. Where insufficient evidence still exists, no further work would be undertaken. Approximately 70 cases have pre-2007 disputes although experience has shown that not all records have been destroyed, so the impact of this measure is difficult to quantify.
 - Disseminating the Linklaters advice, making clear that Post Office considers itself to have very limited liability and almost no liability in respect of consequential loss. This would be justified on the basis of being open and transparent with those who have submitted cases. This will impact most strongly on those subpostmasters who have submitted very large claims – those in the hundreds of thousands or millions of pounds. The latest assessment of 70 detailed claims shows nine with values in excess of £1M and six with values between £500K and £1M.

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- Setting and enforcing hard deadlines for the 40 outstanding Case Questionnaire Reviews, requiring all to be submitted within a month or have their application removed from the Scheme. This would dramatically shorten the tail of the Scheme. It is hard to see how this position could be widely attacked as unreasonable, as Post office is making a contribution towards the cost of the applicants advice and as the Scheme closed in November 2013 and all but a few applicants (whose entry to the Scheme was paused for various reasons) have therefore now had at least six months to submit their detailed case.

Option 3: Completing the Post Office investigation in each case and moving the governance and management of the Scheme in-house¹

- 3.8. Under this option we would publish a report on Horizon and the mediation Scheme setting out the legal position around the contract and liability. The Scheme administration and management would be moved under Post Office's sole control with the Working Group disbanded and Second Sight's engagement ended. Post Office would commit to investigate all cases and disclose the findings to the applicant and would mediate a substantial (but significantly reduced) number of cases. We would publish a report at the end of the process.
- 3.9. This option would substantially reduce administration costs and allow the Post Office to "take control" of the Scheme and its associated risks (such as adverse PR). We estimate the whole life cost for this option at £7.7M. The option would also release management time as the Scheme would conclude more quickly than under the other options (by December 2014).
- 3.10. This could be justified publicly by setting out the case that we are taking action in the absence of any evidence of systemic failures with the Horizon IT system during the last two years, mounting costs which are not in the public interest and alongside clear legal advice around the expectation gap.
- 3.11. We would argue with stakeholders that there are further motivating factors including the projected timescale, the diversion of senior management resource which the Scheme demands and our grave concerns over the quality of work provided by Second Sight.
- 3.12. The approach would undoubtedly lead to negative PR, although given the strength of feeling by some applicants and the JFSA it is inevitable that the business will need to manage this – and seek to minimise it - at some stage. This option would afford the opportunity of being able to plan and prepare for this, and have greater control over the external messaging.
- 3.13. However, as set out at the beginning of this section, we must also have regard for the impact this approach would have in relation to our shareholder and other key stakeholders. In particular, the Post Office minister made commitments in

¹ Further details of this option are in a table at page 6 of the accompanying slide pack
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Parliament in relation to the continuing role of Second Sight in 2013 and we have a duty to consider this in assessing options for the future.

- 3.14. It would be likely to provoke calls for a further Parliamentary statement – which could be granted – along with adverse comment by MPs. This approach also carries risk in relation to Sir Anthony Hooper, chair of the Working Group.
- 3.15. Stakeholder plans would of course be developed in detail for this option along with a detailed media handling strategy.

4. Legal Risk

- 4.1. Post Office has considered the risk of judicial review (JR) in relation to the Scheme and the options at our disposal. In this context it should be noted that there is a low bar to bringing a judicial review action even if unmeritorious (there were over 2,500 non-immigration Judicial Review applications in 2011) so any change to the Scheme might bring such a challenge.
- 4.2. The likelihood of any such challenge succeeding is linked to how far Post Office strays from the public commitments that have been made about the Scheme. The key public commitment is to investigate complaints brought under the Scheme, and a secondary commitment is the presence of independent oversight of the Scheme.
- 4.3. Under the status quo there is minimal risk of JR as the Scheme is continuing in line with all public statements. The second option increases very slightly the risk of judicial review, but it is assessed that this does not increase significantly as both the investigation and independent oversight are maintained.
- 4.4. The third option is more difficult to assess as it depends on the extent to which the Scheme is redesigned, and the extent to which the Courts conclude that an expectation could have reasonably developed of independent oversight.
- 4.5. The costs for the initial work to bring on a Judicial review case has been estimated at £7.5-10K (for acknowledgement, summary of grounds, and preparing for court's decision to proceed). If a case proceeds the whole way it could cost a further £40-100K depending how serious and involved the matter is and how much resource is deployed.
- 4.6. Second Sight's role was intended to increase confidence that the scheme has independent oversight, but if it takes too long or is too expensive there is then good reason to change approach. We have built up comfort that we can have independent in-house investigation by setting out who is in individual teams and what they have been tasked to do.

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5. Cost

- 5.1. The forecast spend, assuming the Scheme completed by end of October, was £7.5M. Second Sight's latest productivity estimates mean that the Scheme is more likely to run until November 2015 at a cost closer to £12.5M.
- 5.2. Administering the Scheme and supporting the Working Group is time consuming and costly, therefore the longer the Scheme runs the greater the costs incurred. We will provide further modelling for the Sub Committee but it should be noted there are a number of significant costs and the amount of money we are attempting to save is predicated on a number of factors such as moving Second Sight from "time and materials" onto a tightly managed piece rate (which even at a rate of £3.4K per case would save over £600K on the current monthly rate of £60K pcm for 12 cases).
- 5.3. We estimate that each case mediated is likely to cost between £8K and £10K, therefore the fewer cases that are mediated the greater the savings. The cost of investigation and associated legal review is currently £135K pcm which is unlikely to reduce substantially until Post Office's investigations are close to being completed.
- 5.4. Further details of cost implications for each option are in a chart at page 4 of the accompanying slide pack. Due to the number of variables being modelled these estimates are provisional and will be refined depending on the Sub Committee's decision.

6. Communications and Stakeholders

- 6.1. It is important to stress that there is no option – including one where we continue as we are – which is free from risk in relation to adverse PR, brand damage and difficult stakeholder handling challenges. Indeed, maintaining the status quo carries the risk of prolonged and repeated adverse PR in particular as cases reach the end of the road, whether to the satisfaction of the applicant or not.
- 6.2. With the prospect of closure for the Scheme as far away as the end of 2015, we face the prospect of adverse PR and critical coverage for the next 18 months – albeit via a small number of outlets – and a further hit in 2016, almost four years on from beginning the investigation, as the investigation process comes to an end and we publish a final report.
- 6.3. There are risks too in the further two options set out in this paper. Both offer very difficult stakeholder handling challenges and the prospect of negative PR. While the latter could be substantial, we believe it to be more manageable than in the "status quo" option, primarily because we would take a degree of control not previously available. Moreover, we believe we could limit the damage in relation to the time the issue remained "in the news" and the depth of coverage.
- 6.4. The stakeholder challenges are more complex. While the Scheme plays into a number of Post Office stakeholders, the critical relationships are those with our

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shareholder, Sir Anthony Hooper and James Arbuthnot MP. Detailed stakeholder planning approaches would of course be developed for the relevant option and more details on this and communications approaches are included in the accompanying slide pack at page 7, along with a proposed timeline.

7. Conclusion and Next Steps

- 7.1. In considering the options we have sought to consider what is in the best interests of the business, its people and its customers, as well as the applicants. This means focusing on commercial factors such as the costs and management time involved, along with ensuring an approach which means all cases receive due consideration. A further factor, specific if not unique to the Post Office is the Governmental angle. Retaining the confidence of the Government, and having regard to statements made in Parliament in 2013, is critical to the Post Office's future operation and should be prioritised in that light within the consideration of the options.
- 7.2. This is an extremely challenging judgement call with a number of factors at play. In considering our recommendation we have had regard to the cost, reputation, stakeholder and shareholder implications of the various options. The whole life costs including spend to date from August 2013 to conclusion are estimated at: £12.5M for Option 1; £10.7M for Option 2; and £7.7M for Option 3. These costs exclude any compensation payments.
- 7.3. It is the view of the Programme, Legal and Communications and Corporate Affairs teams that the third option – where the Scheme is effectively moved in-house – is the one which is in the best interest of the business in a pure “commercial” sense. There is a weight of evidence to support this view, including value for money, time scales, concerns around the cost and quality of the Second Sight output, the diversion of senior management time and the critically important point that in two years of investigation nothing has been uncovered to raise doubts about the issue at the heart of this debate – the operation of the Horizon computer system.
- 7.4. We must however have regard to wider considerations. In considering the best (long term) interests of the business we must take into account our position as being wholly owned by Government. We recognise that we would place the Post Office's shareholder, and particularly the minister, in a difficult position were we to move ahead with our preferred option without first taking steps to discuss it with the Shareholder Executive and the minister, and to set out other options and our handling plans.
- 7.5. In considering these options it is also clear that whether we were take our preferred option or not, there is a pressing need to strengthen our position in relation to the Working Group and set out our position – within the Terms of Reference – in relation to its ways of working. Also, time is of the essence as the scheme continues to progress as now and will continue to do so until such time the Post Office decides on and implements a different approach

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7.6. In conclusion, therefore, we recommend to the Sub Committee that:

- Option one is rejected as untenable given the challenges it poses to the best interests of the business and value for money
- The business takes the opportunity to set out the position in full to the Minister, to seek views on the options considered and to make the case for option three
- Subject to this discussion, communications and handling plans are drawn up in detail for options two and three
- The Programme Team is authorised to develop an approach which would set out option two to the Working Group at the earliest opportunity, and subject to the discussions set out above

Chris Aujard and Mark Davies

03 June 2014