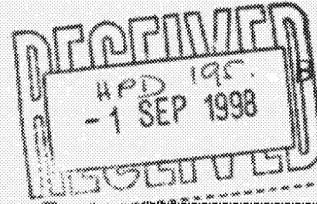


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To: POCL
Atten:Ref: Joe Ashton
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From: Hamish Sandison
Client: BA/POCL
Matter: Counterspace Dispute
Account No: BPOCL/0001
Date: 1 September 1998

Number of pages (including this page) : 11

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Message:

Please see attached final version of Hamish's Memorandum "A Recommended Negotiation Strategy".

50 Fetter Lane
London EC4A 1JP
Telephone: GRO
Facsimile: GRO
Telex: GRO
Birds G
DN
119 London
Web Page: www.birds.com

- Partners
D Harris
C J Comp
D W Claythorpe
T M Cook
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MEMORANDUM

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90 Fetter Lane
London EC4A 1JP

Telephone
GRO

Facsimile
GRO

Telex
GRO Birds G

DX
119 London
Web Page
www.twobirds.com

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TO: Pat Kelsey, BA/POCL Programme, Head of Contracts

CC: Joe Ashton, PO Legal Services
Andrew Davies, Project Mentors
Sarah Graham, DSS
George McCorkell, BA
Dave Miller, Horizon
Marilynne Morgan, DSS
Ron Powell, DSS
Mena Reno, Horizon
David Sibbick, DTI

FROM: Hamish Sandison, Bird & Bird

DATE: 27 August 1998

RE: The Horizon Project - A Recommended Negotiation Strategy

Partners
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G E Camps
D M Caythwaite
T M Cook
R N Sees
P J Christie
P Smith
D W Byam-Cook
G J H Smith
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D Kerr
M Macdonald
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Introduction

- I have been asked as the Joint Programme Lawyer to summarise my recommendations for a negotiating strategy to place the DSS and POCL in the best possible position for the negotiations with ICL Pathway which will follow an inter-ministerial decision on the way forward for the Horizon project.
- My recommendations cover the following issues:
 - negotiation versus litigation;
 - outline of a two-stage negotiation strategy;
 - preparatory activities;
 - stage 1 of negotiations;
 - stage 2 of negotiations;
 - the agreement stage;
 - the litigation stage; and
 - the Government as plaintiff or defendant.



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Negotiation or Litigation?

3. In discussion with colleagues at the DSS and POCL, a number of "pre-litigation activities" have been mentioned which might form part of a public sector negotiating strategy. However, for a number of reasons, including the fact that:

- there is no question of an immediate writ being issued by either of the public sector parties; and
- a negotiated settlement which avoids litigation is the preferred route for achieving whichever option is chosen; and
- we see litigation as a valuable means of achieving a negotiated settlement, but not as an end in itself,

I hope it can be agreed at the outset that it would be misleading to refer to these activities as part of a "litigation strategy" or a "litigation plan," all of which would give an entirely false impression that we were committed to litigation. Instead, I believe that it is much more accurate to refer to these activities as preparatory steps in a negotiation strategy which includes litigation as a last resort in the event that a negotiated settlement cannot be agreed on acceptable terms with ICL Pathway.

4. I also suggest, as a matter of principle, that litigation should not be threatened unless the party making the threat is prepared to carry it out.

Outline of a Two-Stage Negotiation Strategy

5. With these important preliminaries out of the way, I have invited the public sector parties to consider a two-stage negotiation strategy which might include the following main phases of activity:

- (1) Preparatory activities, including establishing a standstill agreement, and preparing for possible litigation as a last resort; and
- (2) Stage 1 of negotiations: following a public sector decision in principle on the way forward, communicating that decision to ICL Pathway for them to accept or reject in principle; and
- (3) Stage 2 of negotiations: assuming that ICL Pathway accept the decision in principle (if not, you could go straight to 4(b) below), conducting detailed discussions with ICL Pathway to agree terms for implementing the decision in principle; and
- (4a) Agreement stage: if the negotiated terms are considered acceptable, endorsing those terms in a jointly agreed settlement document; or
- (4b) Litigation stage: if the negotiated terms are not considered acceptable, or

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if ICL Pathway rejects the decision in principle and further negotiation is not considered worthwhile, commencing legal proceedings against ICL Pathway as soon as the standstill agreement has expired.

These phases of activity are described in greater detail below.

6. As regards the timing for our recommended negotiation strategy, I believe that the following target dates are achievable and should be in our sights:

- standstill agreement in place before the end of August. ?
- decision in principle on the way forward - early September.
- meeting with ICL Pathway to communicate that decision (Stage 1 of negotiations) - mid September.
- complete detailed negotiations and report back (Stage 2 of negotiations) - mid October.
- Public announcement of agreed settlement or commencement of litigation - end of October.

do we understand this process?

(1) Preparatory Activities

7. A number of activities are required to prepare the DSS and POCL for substantive negotiations with ICL Pathway. These include:

- issuing a letter to notify ICL Pathway of the expiry of the 13-week cure period (already sent on August 14th);
- sending a holding letter from the Secretary of State (already sent on August 20th);
- establishing a standstill agreement (already drafted by Bird & Bird and awaiting DSS/POCL approval);
- preparing more generally for possible litigation as a last resort, including commissioning further fact-finding work by Project Mentors, appointing counsel and gathering documents in support of a writ and statement of claim against ICL Pathway (already under way).

(a) The thirteen week cure letter (14 August 1998)

8. The purpose of this letter was:

- to note the expiry of the thirteen week cure period at the end which the DSS is entitled to terminate its agreement with ICL Pathway;

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- to make clear that it is not the Department's present intention to terminate its agreement with ICL Pathway or to exercise any other remedy to which it is entitled, such as liquidated damages for ICL Pathway's delay; and
- to reserve all future rights and remedies in respect of ICL Pathway's breach.

9. In line with previous practice, the letter was sent on 14 August 1998 by you, as joint Head of Contracts for the BA/POCL Programme (although making clear that you were writing only on behalf of the DSS), to John Bennett, Managing Director of ICL Pathway. As on previous occasions, you also telephoned Tony Oppenheim, John Bennett's number two, to make clear that the letter was issued as a necessary legal formality, and not to signal any imminent legal action. Thus, while I expect we shall receive a formal written rebuttal in due course, there is no reason to believe that your letter will precipitate a more aggressive response from ICL Pathway. Even viewed as a legal formality, however, the thirteen week cure letter will still have served a useful purpose, namely, to place the DSS in a position where - should the Secretary of State so decide - it would be able to terminate its contract with ICL Pathway by notice with immediate effect, rather than by means of a notice which could not under the contract take effect for a further thirteen weeks.

(b) The Secretary of State's reply to Keith Todd (20 August 1998)

10. The purpose of this letter was to reply to Keith Todd's previous letter requesting an urgent government decision on the way forward for the Horizon project. As sent, the reply:

- restated the Department's commitment to an early public sector decision;
- explained that, with the government reshuffle and holiday commitments following immediately thereafter, it was not possible or sensible to arrive at a public sector decision before the summer recess; and
- expressed the hope that the public sector parties would be in a position to communicate their decision in principle to ICL Pathway by mid-September.

11. In this way, the Secretary of State's letter advanced two important wider objectives. First, it presented a reasoned defence against any potential claim by ICL Pathway that the DSS and POCL have refused to negotiate in good faith (as required by the Related Agreements) in response to the commercial proposals submitted by ICL Pathway late last year for renegotiating the contractual baseline between the parties. (Obviously, however, as I have previously advised, this defence cannot be sustained indefinitely, and the public sector's risk of exposure to liability for ICL Pathway's additional costs for failure to negotiate in good faith increases with each month, as do the costs themselves. I for one do not feel confident trying to justify the government's further delay much beyond the end of the normal summer holiday period in early September.)

need to
look at
this

12. Secondly, the Secretary of State's reply to Keith Todd set the scene for the substantive negotiations with ICL Pathway which are to follow the public sector's decision in principle. It is important to note, however, that - quite rightly - the Secretary of State's

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letter gave no specifics about the negotiating process. Thus, if and when the negotiation strategy outlined below - or anything like it - is agreed, it will be important in my view to give ICL Pathway some advance warning of what is proposed. For convenience, I suggest that the negotiating process could best be outlined in a letter from you to ICL Pathway to accompany the proposed standstill agreement.

(c) Standstill Agreement

13. Legitimate concerns have been expressed that, fearing an unfavourable public sector decision, ICL Pathway might see it in their interests to launch pre-emptive litigation against the DSS or POCL or both of them. I regard these concerns as premature: as long as a favourable decision is still on the cards, I consider it highly improbable - not to say irrational - for ICL Pathway to sue the decision-makers. Nevertheless, the possibility of pre-emptive litigation by ICL Pathway cannot be ruled out; rational behaviour is not guaranteed; and I would not be prepared to advise the DSS or POCL that defensive action was unnecessary. ✓

14. In principle, two forms of defensive action are available against a pre-emptive strike by ICL Pathway. The first form of defence is, of course, attack: to sue ICL Pathway first. As far as I am aware, there is no support for this option. In the first place, it is not practical: neither the DSS nor POCL is ready to mount a properly prepared and fully evidenced statement of claim, although a short form writ without statement of claim could be issued within a matter of days. Second, and more important, it would seem to be wrong in principle, as well as difficult to defend publicly, for the public sector parties to bring legal proceedings against a major contractor without first using all reasonable endeavours to reach a negotiated settlement of the underlying dispute. For these reasons, I cannot recommend immediate litigation by the DSS or POCL to avoid pre-emptive litigation by ICL Pathway. ✓

15. The second form of defence is what I have called a "standstill agreement," also known as a "moratorium agreement". The essence of this approach is that all the parties to a standstill or moratorium agreement commit not to sue one another for a specified period of time while they are attempting to negotiate an agreed settlement of any differences between them. In addition, among other things, the parties usually agree to continue performing their contractual obligations and to keep their discussions confidential. At the end of the specified period, if agreement has not been reached, they are free to sue each other; but in the meantime, litigation over the dispute is prohibited, and indeed any attempt by one party to sue the other party during this period can be stayed by the courts. However, it is perfectly possible for the parties to agree that a separate dispute (such as POCL's current counterspace dispute with ICL Pathway about who is responsible for modifying post office counters to make them fit for installing the necessary computer equipment) should be dealt with separately, whether by means of arbitration or otherwise: the proposed standstill agreement has been drafted accordingly so as to ensure it does not interfere in any way with POCL's counterspace arbitration procedure.

16. We have used a standstill agreement of this sort with considerable success on numerous occasions, not only to achieve a negotiated termination of a contract without litigation, but also to facilitate a contested renegotiation of an ongoing contract. What it does is to create a less pressured breathing space within which the parties, without fear of pre-emptive litigation, can seek to resolve their differences. For these reasons, we cannot

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recommend it too highly in the circumstances facing us here, where there are legitimate concerns about pre-emptive litigation by ICL Pathway, and the public sector parties are neither ready nor willing to launch pre-emptive litigation themselves. Indeed, I would have to say that we consider a standstill agreement of some sort to be a necessary pre-condition of the two stage negotiating strategy recommended in this Memorandum, especially since the risk of pre-emptive action by ICL Pathway rises significantly after a decision in principle has been communicated to ICL Pathway (Stage 1) and before detailed negotiations have been completed (Stage 2).

17. By the same token, I consider it vitally important that POCL agrees to join in any standstill agreement established with ICL Pathway. Of course, a standstill agreement between the DSS and ICL Pathway alone would not be without some value. Nevertheless, if POCL did not join in, then ICL Pathway would be free to sue POCL. Moreover, recent communications from Keith Todd indicate that they believe they have identified weaknesses in POCL's performance which would justify a claim for damages against POCL on its own. Thus, without a tripartite standstill agreement, I believe that POCL would be very much at risk.

18. A draft standstill agreement is now ready, and has been circulated to the DSS and POCL for review and comments. Once approved by both the public sector parties, we would aim to send it to ICL Pathway with a cover letter from you which (as suggested above) would set out the proposed negotiating process. We would, of course, seek approval of such a letter by the DSS and POCL before it was sent out. As detailed below, we consider it essential that the standstill agreement is in place before substantive negotiations with ICL Pathway (i.e. Stage 1) are commenced.

(d) Preparing for litigation as a last resort

19. In order to sustain a credible negotiating strategy of any kind, our strong advice is that the public sector parties must be prepared to sue ICL Pathway in the event that a negotiated settlement cannot be agreed on acceptable terms. This advice applies whichever option is chosen for the Horizon project.

20. While reserving the Secretary of State's position to decide whether a threat of litigation should be made or indeed carried out, the DSS has agreed that preparations for litigation as a last resort should be started immediately and has instructed us to carry out the necessary preparations. POCL has also been invited to participate in these preparations. Even if (as we all hope) litigation is never required, I am sure that the costs of preparing for litigation will not be wasted, since the stronger the case we prepare for litigation, the stronger our position will be in negotiations with ICL Pathway, who are likely to settle on acceptable terms (or at all) only if they believe that they cannot achieve more favourable terms through litigation.

21. In order to prepare for possible litigation, at least three parallel streams of work are required. These include:

- commissioning further fact-finding work by Project Mentors, focusing particularly on the accusations levelled over recent months by ICL Pathway

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against the public sector parties;

- appointing counsel, including a QC and a junior barrister acceptable to both public sector parties;
- collecting the documents necessary to support a writ and statement of claim against ICL Pathway.

22. Each of these streams of work is described in greater detail below in separate sections of this Memorandum.

(2) *Stage 1 of Negotiations*

23. As we see it, the first stage of substantive negotiations with ICL Pathway must involve at a minimum a decision in principle on the way forward for the Horizon project, and a communication of that decision to ICL Pathway for them to accept or reject in principle. Because further time would be available for detailed negotiations at Stage 2, ICL Pathway would only need to be given a few days to accept or reject the decision in principle. And because there is a real risk that any rejection by ICL Pathway might be followed by litigation against the DSS or POCL or both of them, we consider it essential that the standstill agreement described above is agreed by all the parties *before* ICL Pathway is told of the decision in principle.

24. I offer no comment here on the choice of a way forward for the Horizon project: I have advised previously on the legal implications of the various options under discussion. As for communicating any decision to ICL Pathway, I envisage that this will be done at the highest level, both at a face-to-face meeting and also in writing. This communication should also define the parameters for the Stage 2 negotiation, including a fixed timetable and any financial or other limitations on the public sector's willingness to negotiate terms. In addition, if authorised, ICL Pathway should be left in no doubt that the public sector parties are prepared to litigate if acceptable terms are not agreed at the end of Stage 2 or if the decision in principle is rejected outright before the beginning of Stage 2.

(3) *Stage 2 of Negotiations*

25. If ICL Pathway accept the decision in principle at Stage 1, or at least do not reject it outright, we can see no alternative to a further stage of detailed discussions to agree terms for implementing the decision in principle. We think this is unavoidable even if the decision in principle is to terminate the entire project (Option 3 in the Report of the Treasury-led Working Group): even under a termination scenario, it will still be necessary to negotiate who pays what to whom (will ICL Pathway compensate the public sector parties? if so, how much? will the public sector parties compensate ICL Pathway?) as well as all the other details for an orderly run down of this massive project, e.g., the return of data to the public sector parties, the exercise of options to buy back assets used by ICL Pathway to provide the services, etc.

26. In the case of Option 1 (continuing the project as is) and Option 2 (continuing the project but without the benefit payment card elements), the need for a further stage of

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detailed discussions after Stage 1 is self-evident. Quite apart from negotiating the shape of each option in detail, there is a list of 10 to 20 outstanding commercial/technical issues between the parties which have been on hold pending the outcome of the Treasury-led Review: it will be necessary - as well as very much in the interests of the public sector parties - to resolve these outstanding issues before a final decision to proceed or not is made at the end of Stage 2.

27. If ICL Pathway rejected the decision in principle at Stage 1, and if litigation was authorised, the public sector parties could proceed to sue as soon as the standstill agreement expired. Alternatively, and this might be more attractive in the case of Options 1 and 2, you could first attempt to negotiate an agreed termination of the project (i.e. Option 3) before proceeding to terminate and sue if those negotiations did not produce acceptable terms for an agreed termination at the end of Stage 2. In the case of Option 3, if ICL Pathway rejected the decision in principle at Stage 1, it may be that there would not be any point in proceeding to Stage 2 of negotiations; the alternative would be to proceed immediately to terminate and sue.

28. As noted above, any negotiations under Stage 2 would be conducted within a fixed timetable and within strictly defined financial and other limitations, some or all of which could be communicated to ICL Pathway at Stage 1. We do not envisage an open-ended negotiation, and we recommend that the degree of discretion to be given to the negotiating team is clearly defined in advance by the public sector parties.

(4a) The Agreement Stage

29. At the end of Stage 2, we envisage that the negotiating team will report back to the public sector parties on the outcome of its negotiations with ICL Pathway. This will give everyone concerned an opportunity to decide whether the terms on which the decision in principle can be implemented are acceptable or not. If these terms were considered acceptable, they would be embodied in agreed amendments to the Related Agreements (in the case of Options 1 and 2) or in an agreed termination agreement (in the case of Option 3). In both cases, the standstill agreement would then expire upon execution of the agreed settlement documentation.

30. If the negotiated terms were not considered acceptable, and if litigation was authorised, the public sector parties would then proceed to the litigation stage described below. Alternatively, in the case of Options 1 and 2, if the negotiated terms were not considered acceptable at the end of Stage 2, you could first proceed if you wished to a further stage of negotiation to attempt to negotiate an agreed termination of the project before proceeding to the litigation stage. In the case of Option 3, if the negotiated terms were not considered acceptable at the end of Stage 2, there would seem to be little point in holding a further stage of negotiation, and we assume that you would proceed immediately to terminate and sue.

(4b) The Litigation Stage

31. If the terms negotiated at Stage 2 or any subsequent stage of negotiations were not considered acceptable, or if ICL Pathway rejected the decision in principle at Stage 1 and

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a further stage of negotiations was not considered worthwhile, the public sector parties would then terminate the Related Agreements and commence legal proceedings against ICL Pathway as soon as the standstill agreement expired. The mechanics of termination are described in my separate Memorandum of today's date on the "Contracts with ICL Pathway" (see paragraphs 13-14).

32. For the reasons given in paragraphs 41-42 below, we recommend that the public sector parties should seek to position themselves as the plaintiffs in any litigation against ICL Pathway. This means that all the necessary activities (described elsewhere in this Memorandum) to prepare for litigation must be taken before the standstill agreement expires. It will also be necessary to ensure that the public sector's writ is issued before ICL Pathway is able to issue its own.

33. In suing ICL Pathway, the public sector parties could claim damages up to the financial limit of £200m in the Related Agreements.

Project Mentors/Expert Assistance

34. Project Mentors - acting as our subcontractors - were jointly commissioned by the DSS and POCL earlier this year to consider who was responsible for ICL Pathway's failure to complete Operational Trial by the contractual due date of 21 November 1997. They found that ICL Pathway were largely responsible for project delays leading up to the November 21st deadline, and that the public sector parties had neither caused nor significantly contributed to them. However, this review was limited to delays occurring *after* the replan agreed by all parties in February 1997. Since then, Project Mentors has been jointly commissioned to do some further work to assess the accusations by Keith Todd in a paper entitled "Examples of Problems Facing Pathway" which was sent to Peter Mathison on 1 June 1998.

35. We now propose and the DSS have agreed that Project Mentors' remit should be broadened to provide expert assistance generally in relation to any possible litigation by or against ICL Pathway. In the first place, their new remit would include an assessment of delays occurring *prior* to the February 1997 replan, focusing in particular on those areas where ICL Pathway allege culpability by the public sector parties. In addition, Project Mentors would be expected to assess the strengths and weaknesses of the public sector's case in general. This work is already under way.

36. I believe that Project Mentors' assistance is vital, not just in preparing for possible litigation, but also in strengthening the public sector's hand in advance of negotiations with ICL Pathway. I also believe - and the DSS agrees - that POCL should be invited to participate in their work. POCL has already replied favourably to Peter Crahan's invitation to support Project Mentors' pre-February 1997 replan work, and POCL has been invited to support their wider remit in relation to possible litigation generally.

Appointment of Counsel

37. It is necessary that counsel - including one QC and one junior barrister - should be appointed as soon as possible to assist us in preparing for possible litigation. The DSS has

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agreed, and we have discussed some names with them, since the junior barrister should be on their approved list of panel counsel, while the senior barrister needs to be nominated by the Attorney General (who could also approve a junior if none of the panel were available). In addition, I would wish to canvass POCL's views and, if at all possible, select junior and senior counsel who were acceptable to POCL as well as to the DSS. We are taking this forward over the next few days with a view to appointing counsel with the approval of both public sector parties at the earliest possible time.

38. In addition, the DSS has requested and we agree that as soon as counsel have been appointed, they should be invited to give an opinion on the strength of the public sector's case, including the quantum of damages recoverable by the public sector parties. This work needs to be built into the overall timetable.

Collection of Documents

39. In view of the vast amount of documentation relating to this project, we have proposed and the DSS has agreed that we should start work immediately to gather the documentation needed to support a writ and statement of claim in any possible litigation against ICL Pathway. It was agreed that we should work closely on this task with Project Mentors (who have a good knowledge of the project documentation as a result of their previous investigations) and with the BA/POCL Contracts Office (who have probably the best collection of documents relating to the contract procurement and management process). This work is already under way.

40. Again, in the hope that our recommended negotiation strategy meets with POCL's approval, I have invited POCL to assist us with our document collection work.

Plaintiff or Defendant?

41. I have reviewed the question of whether it is important to position the public sector parties as the plaintiffs in any litigation against ICL Pathway, and I accept that it makes no difference from a strictly legal point of view: the DSS and POCL would enjoy precisely the same rights - substantive and procedural - as plaintiff or defendant.

42. From a presentational point of view, however, I would argue - as I have consistently advised the BA/POCL programme - that it is vitally important for the public sector parties to position themselves as the plaintiffs; if they were to be publicly identified as the defendants in a "wrongful termination" action, I suggest that this would be a public relations victory for ICL Pathway which even a subsequent legal victory for the DSS and POCL could not completely reverse.