

Annual Legal Risk Review: 2017

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Meeting date: 29 January 2018

Executive Summary

Context

The ARC Terms of Reference require it to undertake an annual review of risks. This paper provides the Committee with a review of the key legal risks during 2017, their management and what this means for our control environment.

Questions this paper addresses

- What are the key Legal risks?
- What controls are in place to manage these risks?
- What is the overall position and further actions required?

Conclusion

1. The Post Office takes its legal and regulatory responsibilities seriously and consequently has an averse risk appetite for non-compliance with law and regulations or deviation from its business conduct standards. In respect of contractual risk, it has averse appetite for risk taking which would alienate or lose significant groups of profitable customers but a tolerant risk appetite for legal and regulatory risk in those limited circumstances where there are significant conflicting imperatives between conformance and commercial practicality.
2. Within the last 12 months, the legal department ("Legal") has managed approximately 1,800 matters, mostly from Retail, Operations, and Financial Services & Telecoms areas of the business. Further development of MI will be undertaken in 18/19 to better understand areas of risk within each area of the business.
3. Legal seeks to enhance the legal maturity of the business strategically (aligned to the Board's risk appetite and Post Office's strategic imperatives) and efficiently (in accordance with its budget). Operational managers, as a first line of defence, needs to understand legal risk and, with second line support from Legal, incorporate appropriate controls. Such controls need to be complied with and enforced by the business.
4. The main areas of concern are:
 - Contract management continues to present a legal risk to the business although enhancements have been made to the control environment. Contract management must be seen as a core competency of Post Office given that Post Office's business model is focused on the distribution of third parties' goods and services (all of which are underpinned by a contract) and its highly outsourced model for infrastructure support. Further enhancements and enforcement of controls within the business should prevent services being provided without appropriate written contracts in place or contracts being breached because the obligations imposed are not either understood or monitored. Legal are working closely with Procurement to embed a stronger contract compliance culture. Supplier managers are made aware of their accountability to evidence their compliance with meeting their respective contractual obligations. In addition, significant improvements have been introduced over the last 12 months such as the further development of a central repository of contracts through the existing Bravo procurement

system as well as the provision of contract and PCR training, greater enforcement of the CAF process, and further development of the Contractual Obligations Spreadsheet.

- The business continues to improve its understanding of the complex legal and regulatory framework within which it operates. Post Office is in the process of finalising accountabilities and responsibilities for compliance with material laws and regulations which apply across the organisation. The refinement of corporate policies (AML, ABC, and Information Security) and operational processes (e.g accessibility assessment in the Network Transformation Decision Manual to ensure better compliance with Equality Act) together with training and bespoke legal advice, has allowed the business to better control regulatory risk. The new Law and Trends Forum with representatives from across the different business areas enable Post Office to proactively identify emerging legal and regulatory developments and embed appropriate processes to support compliance.
 - Many of Post Office's activities need to be considered in light of competition rules, and there needs to be better understanding of the potential implications of commercial activities such as acquisitions or joint ventures and even information sharing arrangements. In the last 12 months, Legal developed a Compliance Guidance and FAQs to support the operational managers understand this risk together with bespoke training. Further competition law training will be rolled out over the next financial year.
 - The strategic direction of a number of areas of the business involve potential acquisitions or joint ventures which give rise to a complex matrix of legal and operational risks. Corporate M&A knowledge is dependent on a few core individuals. Legal is developing a Corporate Acquisition Checklist and challenge process aimed at enhancing risk management of these projects.
 - The Postmaster Litigation has been reported separately to the GE and as such is not within the scope of this report. However, as a result of the litigation, the recovery of agent losses and prosecutions have become significantly more challenging. The risk is that the deterrent effect of such recovery actions or prosecutions has diminished, and opportunistic behaviours by agent may be increasing.
 - Post Office takes a reactive approach to brand protection and enforcement of its intellectual property rights. Basic controls have been employed, such as cease and desist letters but further enhancement could be achieved through a formal trade mark infringement process for material infringement incidents.
5. Legal has established a draft Legal Policy which will shortly go through governance. This Policy sets out how Post Office manages legal risk and the controls which are in place. Legal supports the approval and execution of legal documents in accordance with the Board approved delegations of authority; a legal Risk Report is provided in respect of all new material contracts; legal risks are included in the Risk logs for projects by project managers; legal and regulatory risks are monitored by the General Counsel through the Post Office risk universe and risk registers; and potential risks arising from emerging legal and regulatory developments are identified through the Law & Trends Forum and flagged to the RCC and the ARC through the regular Horizon Scanning report.
 6. Legal is planning to deliver further training during 2018 which will assist managers to better understand core areas of legal risk areas and develop necessary processes.

Input Sought

The Committee is asked to note this report.

The Report

What are the key legal risks?

Contract Management Risk

7. As the Committee is aware, previous internal audit reports and the 2016 Legal Risk report identified risks associated with the contract management and procurement processes. While improvements have been made through the introduction and enhancement of a number of controls, there remains more work to enforce a compliant culture in the business. Current controls include:
 - a contract authorisation process designed to ensure that all legal instruments go through a consistent process with key stakeholders including Finance and Legal;
 - contractual obligations spreadsheet which sets out the key deliverables or actions that each party needs to undertake to comply with the contract. Completion and use of these remains incomplete and inconsistent;
 - Legal has developed house positions with playbooks which set out a range of acceptable negotiated positions for the following contract types: supplier contracts, bill payment contracts, agency network contracts, and employment contracts; and
 - standardised legal risk reports;
8. Within the last 12 months, a central repository of contracts was enhanced and further populated utilising the existing Bravo procurement system which ensures that commercial contracts, property documents and other legal instruments are readily available. There is, however, limitations on this repository as it does not always include Change Controls Notes or Change Management Notes.
9. A number of historic arrangements in which services have been provided without a written contract in place were identified:
 - a. There were c.50 bill payment arrangements where contracts could not be located. This was of particular concern given POL's obligations under its funding agreement with the BEIS to provide SGEI Products of which bill payments is a part. However, the business managers have been utilising the house positions developed by Legal to remediate this issue and provide certainty around those contractual arrangements.
 - b. Further, approximately 5% of all branch agency contracts cannot be located which potentially creates issues for the Postmaster Litigation as well as operational issues. A remediation plan is in place to ascertain those contracts. These contracts involve individual postmasters rather than multiples and therefore do not represent a significant risk individually.
 - c. Finally, the HR Weekly/Monthly dispute, which arose when POL sought to transition weekly pay to monthly, was hindered by a lack of visibility of the various historical versions of employee contracts. The absence of complete written contracts results in uncertainty around the contractual position of the parties which could also give rise to regulatory issues. A project has in place to identify those historical arrangements which is expected to be finalised within the month.
10. It should be noted that the above arrangements are generally historical in nature and represent a small proportion of the total number of contracts.
11. Business managers need to manage their contracts in accordance with the obligations that are set out in the contract. The contract obligations spreadsheet is a document that helps the business map out those obligations. Consistent use of this spreadsheet will mitigate against the risk that Post Office breaches the specific obligations set out in the contract

and/or fails to enforce the obligations owed to it by the third party. This control should be enforced for all material contracts.

Further actions

12. Further enhancement of controls could be achieved with:
 - a new procurement and contract management system (replacement of Bravo) to provide greater functionality and automation in relation to contracting processes. It will be important that, in any such system, business managers who manage the contracts have access to such system.
 - Legal is planning further training to the business in 18/19 to improve their understanding of the contractual obligations and of the impact of contracts on other areas within the business;

Non compliance with legal and regulatory requirements

13. Post Office is a multiline business with a number of complex legislative and regulatory obligations. The RCC and ARC received a report on Post Office's legal and regulatory framework in September last year which set out the material pieces of legislation and regulations that apply to the different business areas across the organisation as well as its key regulators. GE accountabilities and responsibilities of these laws and regulations are in the process of being finalised. This clarification of ownership will provide a further opportunity to enforce existing controls and develop additional controls where appropriate.
14. The key regulators relevant to Post Office include:

HMRC	AML in relation to regulated products and services
ICO	Data Protection (issues involving the use of personal data) and Freedom of Information;
CMA	Competition (anti-trust);
OFCOM	Telecommunications and mails;
FCA	Financial Services (directly relevant to POMS), but also regulates competition in financial services, consumer credit and payments services (in its dual capacity as Payment Services Regulator)

15. Generally, controls supporting regulatory compliance across the business have been clarified or enhanced over the last year. Examples include:
 - The accessibility assessment in the Network Transformation Decision Manual was refreshed and re-emphasised when the Retail team had not completed the assessment in a number of instances (Chobham and Ayleston). Failure to undertake this assessment could expose Post Office and the postmaster to a risk of challenge under the Equality Act;
 - There continues to be instances of non-compliance with Public Contracts Regulation (PCR) which will be addressed separately in the Procurement Director's Report. However, Legal has drafted a Procurement manual designed at improving the business's understanding of PCR obligations on Post Office;
 - Training was provided to relevant stakeholders on GDPR and SMCR;
16. A new Law and Trends Forum with representatives from across the different business areas was established last year to enable Post Office to proactively identify emerging legal and regulatory developments and to design and embed appropriate processes to support compliance. Any such developments will be flagged through the Horizon Scanning Report.

Further actions

17. The General Counsel is in the process of recruiting a Risk & Compliance Director who will refine the new Compliance function, which once established will help to enhance: controls within the regulatory framework within which Post Office operates; understanding of the cross-dependencies and implications of Post Office's various activities, and ascertain and interrogate MI regarding regulatory risks. As Post Office continues to operate in highly regulated sectors that are integral to Post Office's future growth, the development and embedding of a compliant culture is critical.
18. As part of the legal strategy, we proposed to launch a Legal Academy during 18/19 to enhance the business's understanding of core legal risk areas (e.g DPA/GDPR, Regulatory Framework, Competition Law,) and help it enhance necessary first line of defence processes to support compliance with these regulations.

Competition Law

19. Competition law issues arise in a number of contexts:
 - When contracting, Post Office needs to be careful not to include restrictions/benefits which could be deemed to be anti-competitive (certain exclusivities, pricing structures, terms which limit supply/production in a particular market etc.).
 - Restrictions clauses in agency contracts need to be kept under review to ensure that they are still appropriate and not anti-competitive. Legal is presently reviewing network restrictions together with the Restrictions Manager, Paul F Williams.
 - When holding exploratory talks with potential partners (JVs, acquisitions etc.);
 - When participating in industry wide associations; and
 - During procurement exercises - both where Post Office is bidding/involved in a bidding vehicle (e.g. in response to government and utility contracts) and where Post Office is itself procuring goods/services.
20. There are a number of controls of this risk which were enhanced last year including additional personnel in Legal with competition law skills; a competition law guidance manual; competition law FAQs; and training.
21. Legal has seen instances where the language used by business managers in business documents and meetings has not been appropriate and could be construed as being anti-competitive. Given that Post Office is engaging in a number of exploratory discussions with potential partners about acquisitions and/or JVs which will, in some cases, require approval from the Competition Markets Authority, business managers need to ensure that they understand competition law issues (as provided through training), follow bespoke advice from Legal, and utilise the Competition Law Do's and Don'ts FAQs.
22. Restrictions clauses in contracts with agents are monitored and discussed with the Post Office Restrictions Manager, Paul F Williams, to understand the level of compliance with this clause across the agency network and how these restrictions may be compliantly enforced. Paypoint have challenged Post Office's approach previously and Post Office has previously argued successfully that the restrictions policy is needed to maintain the network (as we did, successfully, before the European Commission in relation to Post Office 2015-2018 state aid). Legal is presently reviewing these restrictions to ensure that they remain within risk appetite.

Further actions

23. Given the increased activity which gives rise to competition law risks, Legal will continue to provide competition law training to different areas of the business and project teams to ensure that competition law issues are highlighted early and dealt with appropriately.

Corporate Acquisitions and JVs

24. As noted above, there are a number of business areas within Post Office that are considering acquisitions or joint ventures as part of their strategy. Acquiring third party assets or companies or entering into joint ventures (including contractual joint ventures) involves a complex matrix of issues which gives rise to legal risk. There are only a few key stakeholders in Post Office with significant corporate acquisition experience. Industry analysis reveals that a majority of such projects fail because businesses fail to understand the operational consequences.

Further actions

25. Further enhancement of controls are in progress: POL Legal Corporate Acquisition Checklist and challenge process reviews which together with the existing gating requirements and SME expertise from the external legal panel and consultants should reduce the risks associated with these projects.

Dispute Resolution Management

26. As Post Office seeks to become more commercially independent, there will be a greater emphasis on the need to manage disputes carefully. Over the last financial year, there have been 22 formal disputes of which the following were material:
- 1 Criminal Litigation
 - 1 ICO (ROPSI)
 - 3 Property Litigation Claims (total value of £495,407)
 - 1 Employment Litigation Claims (est. value £366,750)
 - 2 Public Liability Claims (handled by insurers) total value of £43,372.00
27. As set out in paragraph 7-11 above, effective contract management will diminish the risk of disputes arising against Post Office. There have been instances where poor contract management has resulted in informal disputes between Post Office and suppliers. An example was a recent omission to execute a formal change note and the contract's change control procedure was not followed which allowed the supplier to argue that the change note was not binding and that it did not have to provide the (verbally) agreed future service credits (value being £510K). By complying with the controls already in place and adopting the further enhancement, these risk can be mitigated.

Enforcement of Agent Losses and Prosecutions

28. Over the last few years Post Office has undertaken very few prosecutions by contrast to its previous practices. This lack of appetite has been observed by the agency network. It remains to be seen whether the reduction in prosecutions will directly result in higher incidences of opportunistic behaviours, however agent losses are increasing.
29. The Postmaster Litigation matter, currently complicates Post Office's ability to recover agent losses or prosecute for fraudulent losses. The issue arises where an agent who cannot account for a loss makes an allegation that is a subject of the Postmaster Litigation (ie the loss is due to an error with the Horizon system). As this issue is currently before the Court but has not been determined, any formal action against that agent would likely result in a stay of those proceedings (in effect preventing the recovery of the loss until the stay is lifted). This has the effect of frustrating the Former Agent Debt teams' ability to recover losses in 318 cases with a combined value of c.£1.14million. Further, the postmaster of the [GRO] has frustrated the investigation into those transactions (and any consequential criminal or civil legal activity) by joining the Postmaster Litigation as a claimant.
30. [GRO] later this year will determine whether certain additional duties should be implied into the standard postmaster contract, including rights

and responsibilities for branch losses. Depending on the outcome of that hearing it may be possible for Post Office to take a more proactive position on recovery of branch losses.

Service of Proceedings

31. There have been a number of instances of the business failing to identify and respond to service of court proceedings resulting in default judgment or enforcement against Post Office.
32. Post Office is, from time to time, named as a defendant to court proceedings. A Claim form can be served at any place of business which has a real connection with the claim including customer centres and directly managed branches or at the registered office (Finsbury Dials). Post Office personnel may not always forward the Claim or court related documents to Legal which has resulted in default judgement and, in turn, diverted resource and further cost to set aside such judgements.
33. Legal has drafted a "Receipt of Court Documents" process which will be circulated to the Post Office network and placed on the Legal Intranet together with periodic communications will reduce the risk going forward.

Brand and Intellectual Property (IP) Infringement

34. The Post Office brand is one of its more important assets. However, a reactive approach is taken to enforcement of its IP rights. There are examples where Post Office's trade mark or brand has been used in search engines and comparison websites to divert traffic to competitors. Although these are generally not material, the infringement of its rights may cause reputational damage and customer confusion.
35. Present controls involves Legal providing a "cease and desist" letter.

Further actions

36. Legal will draft a Trade Mark Infringement Process with the Group Brand, Communications and Corporate Affairs Director, which will set out a proportionate and risk based approach, to ensure continued brand protection particularly for those incidents involving a material or significant infringement.