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**BATES AND ANR -v- POST OFFICE
GROUP LITIGATION**

draft / ADVICE ON SETTLEMENT

Executive summary

1. The purpose of this note is to provide an overview of the Post Office Group Litigation and to summarise our recommended settlement strategy for an upcoming mediation scheduled for 27-28 November 2019.
2. This is a complex dispute where there are a number of material unknowns. Settlement at this stage of the proceedings therefore will necessarily involve a risk-based judgment in light of provisional assessments of liability and quantum. In our view, the position can be summarised as follows:
 - a. Post Office is likely to be unsuccessful in its defence of most of the claims. Although Coulson LJ's judgment is awaited, we consider it unlikely that Post Office will be given permission to appeal on most of the implied good faith terms. The true battleground in the case is likely to be quantum.
 - b. We consider that settlement at a level between £40m and £65m would be a good result for Post Office. Those numbers are based on a robust analysis of the most significant heads of loss across the 555 claims and take into account a premium for risk, reputational considerations and the anticipated high burn-rate on costs going forward.
 - c. Achieving a settlement will not be a straightforward matter:
 - i. The claims are funded by litigation funders, Therium. Given the level costs invested to date, the funding return - which the Claimants will want covered as part of any settlement - is likely to be disproportionate (we estimate of the order of £75m - £90m and growing). There is therefore likely to be a significant gap between the parties.

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- ii. The Claimants include 61 individuals who were prosecuted by Post Office in the criminal courts. Compromising these claims before the criminal courts have adjudicated on any appeals creates difficulties: it would be unprincipled and also has potentially significant knock-on effects. However, if Post Office were to exclude this highly activist cohort from the settlement process, that is likely to jeopardise the entire mediation.

- d. In view of these issues, there is a strong chance that the upcoming mediation will be unsuccessful. Post Office therefore needs to adopt a negotiating strategy which preserves its prospects of achieving a reasonable settlement later down the line if the November mediation fails. Key elements of the strategy will include:
 - i. Negotiating around Post Office's top numbers at the November mediation only if doing so would close a deal;

 - ii. If the mediation fails, making Part 36 offers to each individual Claimant. This would enable Post Office to (a) shift at least a part of the costs risk going forward and (b) reach out to individual Claimants who may not share the views of the activist members of the class who will likely be in the driving seat in the negotiations; and

 - iii. Maximising pressure by re-focussing the litigation on points where the Claimants are more vulnerable, including a trial of test cases where the weaker individual claims can be brought to the fore.

- e. Resolving this litigation would be of significant benefit to Post Office. Not only would it bring an end to the ongoing cost, diversion of management time and reputational damage, it would allow Post Office to move forward, with the benefit of lessons learned, and focus on its commercial objectives for the future.

Background

- 3. In around 1999/2000, Post Office introduced a computerised electronic point of sale and accounting system called Horizon (the "**Horizon System**"), which sub-postmasters



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("SPMs") were required to use in their branches. The Horizon System requires SPMs to account for stock, sales and takings and, as part of the balancing process, identifies shortfalls or discrepancies. Under the terms of their contracts, SPMs are required to make good any shortfalls out of their own funds.

4. Some Claimants repaid their shortfalls; others hid them by through false accounting so as not to be held accountable for funds they could not, or wished not to, repay.
5. Post Office implemented robust audit and collections procedures to minimise losses from the SPM network. Many offenders had their SPM contracts terminated, some summarily for breach and others on notice. Up until 2013, Post Office in appropriate cases also exercised its powers as prosecutor to convict SPMs of criminal offences - principally theft, fraud and false accounting. Many convicted SPMs pleaded guilty, although it is now said those pleas were motivated by ignorance or pragmatism (i.e. to avoid more serious charges of fraud or theft), rather than true guilt.

The Claims

6. The Claimants are a group of 555 individuals who allege that Post Office's policy of seeking recovery of shortfalls was wrongful because shortfalls were generated by "bugs" in the Horizon System. They also allege that Post Office failed in its "good faith" duties to provide proper training on the use of the Horizon System, to assist with queries or complaints, to disclose the existence of known bugs in the system, to conduct adequate investigations into the cause of disputed shortfalls and to allow suspended SPMs access to records to enable them to challenge Post Office's assumption that unexplained shortfalls were the result of theft or error.
7. As a result of these breaches, they claim damages for the wrongful recovery of shortfalls, the wrongful suspension and termination of their contracts and associated wrongs including harassment, stress related illness and stigma. A breakdown of the claims is attached as Appendix 1.



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The current position in the litigation

8. The litigation is structured as a GLO. Fraser J, the managing judge, has ordered that it be heard as a series of trials on issues of relevance to the claims brought by the Claimant class as a whole.
9. The first trial (the "**Common Issues Trial**") concerned the meaning and effect of the contracts between Post Office and the SPMs. The judgment, handed down in March 2019, was resoundingly favourable to the Claimants. In his judgment, Fraser J found that the SPM contracts were "relational" contracts and as a consequence implied a series of onerous "good faith" terms which undermine, in material respects, the contractual framework which Post Office believed it had in place. Fraser J was critical of Post Office, finding that some of its key witnesses had deliberately misled the Court and described it as having "*a culture of secrecy*". Post Office has sought permission to appeal the judgment (the "**Common Issues Appeal**"). Following the oral permission hearing which took place on 12 November 2019, it seems likely that the majority of the good faith terms will remain in place.
10. The second trial focussed on whether Post Office's Horizon System was, in principle, robust (the "**Horizon Trial**"). The trial concluded in July 2019 and judgment is awaited, although we expect it to be handed down imminently. The trial was dogged with complaints around the adequacy of Post Office's disclosure¹ and allegations that the true extent of problems with Horizon was being concealed in the litigation.² Although the expert evidence on the robustness of the system was relatively compelling, the Claimants will be able to establish that there was a risk (even if small) of bugs causing accounting discrepancies. Leading Counsel for Post Office (Tony de Garr Robinson QC) considers it highly unlikely that Fraser J will give the Horizon system a clean bill of health.
11. A third trial has been scheduled for March 2020. It will deal with the correct measure of damages if the Claimants are able to establish liability in principle³ and will be conducted

¹ Many of the "suspicious" non-disclosures are in all probability red herrings but have been deployed effectively by the Claimants to create a "concealment" narrative.

² The decision not to call Fujitsu's Dr Jenkins (who stated, incorrectly, in some of the criminal trials that Horizon had no bugs) is likely to result in adverse inferences being drawn.

³ This is a peculiar issue to have tried at this stage, before matters of breach. The original order made provision for a trial about both limitation and measure of loss. The limitation issues would have been centred on the Claimants' deliberate concealment defence under section 32 of the Limitation Act 1980.



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on assumed facts, without any evidence. Its scope has yet to be decided. Key points of legal principle that are likely to arise are (a) Post Office's liability for lost earnings claims for extended periods of time (i.e. remuneration until retirement); and (b) a novel claim for the recovery of the Claimants' litigation funding costs as damages.

12. Neither the first nor second trials were concerned with Post Office's liability in respect of the individual Claimants' claims. The impact of bugs and the alleged breaches of good faith duties in individual cases will be left over for future trials, probably involving test Claimants.
13. In parallel with the court timetable, Post Office has agreed with the Claimants to engage in mediation on 27-28 November 2019 with Charles Flint QC officiating as mediator.

Liability Issues

14. Post Office's exposure on liability will likely turn on a consideration of:
- a. Whether Post Office was entitled to hold the Claimants accountable for shortfalls;
 - b. Whether Post Office was entitled to suspend SPMs without pay;
 - c. Whether Post Office was entitled to terminate the Claimants' contracts with or without notice;
 - d. Whether Post Office was in breach of its "good faith" duties and, if so, whether that has a bearing on (a), (b) and (c) or otherwise caused the Claimants any loss.
15. There are distinct issues raised by fact patterns both in the individual claims and by certain categories of Claimants, in particular (a) Claimants convicted of criminal charges; (b) Claimants who have previously settled with Post Office, either under the Mediation Scheme or Network Transformation; and (c) Claimants who were not SPMs (e.g. assistants to SPMs) who had no contractual relationship with Post Office.

Issues raised on the facts of Individual Cases

In view of Fraser J's approach on Common Issues (that Post Office operated a "*culture of secrecy*") and the obvious sympathy he showed to the lead Claimants whose cases would have formed the foundation of the limitation trial, we took the view that confining the trial to measure of loss issues was the least-worst solution.



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16. The fact patterns of the individual claims raise a variety of issues:

- a. In some cases there is compelling evidence, unrelated to the Horizon system, which explains why shortfalls arose (e.g. confessions from Claimants that cash was misappropriated or lost). Outside of the cohort of the convicted Claimants, these are relatively few.⁴
- b. There are other cases where it might be inferred that shortfalls were the result of lax business management or poor accounting practices.⁵
- c. In the majority of cases, however, the cause of the shortfalls remains unknown. It is inherently difficult for Post Office to prove that shortfalls were caused by SPM error because, apart from the Horizon accounting system, Post Office has no visibility over the operations of the branches. Further, there is a paucity of solid documentary evidence, particularly on older cases.⁶
- d. Many Claimants' contracts were terminated because they were submitting false trading balances so that shortfalls did not come to light.⁷
- e. There some cases where the Claimants have found themselves in unfortunate personal circumstances, which is likely to attract the sympathy of the Court.⁸

17. It is clear from the Common Issues judgment that Fraser J is sympathetic to the Claimants' core complaints. In implying the extensive good faith duties he did, he has given the Claimants a legal mechanism for challenging Post Office's approach to the

⁴ For example, [GRO] (Claimant 106) admitted during an audit that he inadvertently left numerous cash pouches (containing £100,000) out of the safe which were erroneously taken from the branch in a mail bag. He has since denied this and suggested he fabricated the story under pressure.

⁵ For instance, [GRO] (Claimant 45) admitted that she never physically counted the money in one office cash supply for a four year period, passwords were not confidential and branch trading statements were not signed when completed. [GRO] was [GRO] due to evidence of cash inflations and false declarations in accounts submitted.

⁶ For example, on the case of [GRO] (Claimant 63) there are no documents available to confirm or deny the Claimant's claims concerning shortfalls.

⁷ For instance, [GRO] (Claimant 99) admitted that both he and one of his employees inflated cash reserves in order to conceal discrepancies and issues with balancing. [GRO] also admitted he did not account for prize money from the lottery correctly on the Horizon System.

⁸ For example, [GRO] (Claimant 12) was [GRO] and he alleges that [GRO] [GRO] resulting from Post Office action against him. At the time of the shortfalls [GRO] [GRO] [GRO] [GRO]



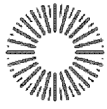
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recovery of shortfalls, suspensions and terminations. Seen in the round, apart from those few cases where Post Office can point to clear documentary evidence of theft or culpable error on the part of individual SPMs, Post Office's prospects of success on liability are not encouraging.

18. At the risk of some oversimplification:

- a. On bug issues, if the findings made in the Horizon Issues judgment are to the effect that Post Office cannot rely on Horizon data as compelling evidence that shortfalls were genuine⁹, there is limited further evidence that Post Office will be able to rely on in support of its case that it was entitled to demand repayment. Post Office did not typically conduct extensive investigations into the cause of shortfalls. Unexplained shortfalls were effectively assumed to be the result of SPM theft or error.
- b. The extensive good faith terms implied by Fraser J operate, at least arguably, as a fetter on Post Office's ability to exercise its express contractual entitlements. Post Office will be constrained to accept that it acted in breach of many of those terms because its working procedures were simply not designed with the good faith terms in mind. (For example, Post Office believed that it was entitled to rely on Horizon System data; it also believed it was entitled to terminate on notice as of right and did not typically turn its mind to the question of what period of notice might, in all the circumstances, be "fair".)
- c. One area of controversy we foresee emerging is whether Claimants who have falsely accounted for cash or stock in order to "cover up" shortfalls can be said to be in material breach simply because they falsely declared their trading balances. On its face, a failure to follow prescribed accounting procedures might qualify as a material breach justifying summary termination - particularly if it was deliberate. Here, however, the Claimants are likely to blame breaches of Post Office's good faith obligations - for example (a) that errors were made as a result of poor training and inadequate helpline support; or (b) that deliberate false

⁹ It would be unwise to speculate what the judgment will say; however if its effect is that Post Office bears the burden of proving that shortfalls were genuine and it cannot rely on Horizon data as compelling evidence of that fact, it will struggle for want of proof. There are few cases where Post Office can in fact demonstrate how or why cash or stock went missing.

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accounting was justified in light of Post Office's policies of demanding repayment and/or terminating summarily without proper investigation or process. There are legal questions around how the good faith duties interact with Post Office's contractual entitlements in these types of scenarios but we can see ample scope for Fraser J treating accounting failures as non-material, either because they were a consequence of breaches by Post Office of its good faith duties or, quite apart from the Common Issues Judgment, because they were not repudiatory in nature. That assessment is borne out by Fraser J's sympathy for Mr Abdulla in the Common Issues Trial notwithstanding an undisclosed shortfall of £4,398.32 discovered on audit, a practice of keeping an undated cheque in the amount of £2,500 in his till and the overstatement of mutilated notes.

- d. Finally, and of obvious practical significance, the findings made about the credibility of Post Office's witnesses mean that, in the absence of solid documentary evidence, factual disputes are likely to be resolved in favour of the Claimants.

Distinct Issues raised by Categories of Claimant

19. There are also distinct issues raised by certain categories of Claimant.

Convicted Claimants

20. There are 61 convicted Claimants. These Claimants face a threshold issue in that the claims made will, for the most part, involve a collateral attack on the judgments of the criminal courts and such claims are liable to fail as an abuse of process. As such, the convicted Claimants would have a civil remedy only if they succeed in having their convictions overturned in the criminal courts.¹⁰
21. Subject to the outcome of the Horizon Trial judgment, Brian Altman QC's view is that the convicted Claimants are unlikely to succeed in their criminal appeals because they face two substantial hurdles: (a) those who pleaded guilty will need to establish a basis for withdrawing their guilty pleas (for example by alleging incompetent legal

¹⁰ Unless, potentially, they can identify causes of action unrelated to the matters in respect of which they were convicted.



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representation); and (b) they will then need to persuade the appeal court that they were wrongfully convicted. Brian Altman QC acknowledges, however, that his assessment might change in light of findings made in the Horizon Issues judgment. The Criminal Case Review Commission (“**CCRC**”), which has been asked to review 34 of the criminal cases, is also awaiting the outcome of the Horizon Trial judgment.

22. It would be unwise to speculate how matters might unfold in the criminal courts. For present purposes, we observe simply that the criminal cases do not on their face appear to be of equal merit. In some cases, the Claimants made detailed confessions as to how and why they (or family members) misappropriated funds.¹¹ In other cases, Claimants allege that they pleaded guilty to false accounting only to avoid the more serious charges of fraud or theft and the associated risk of custodial sentences.¹² On its face, the former category of cases appears to pose less risk than the latter, but this is a specialist question of criminal law.
23. From a technical legal perspective, the correct course for the convicted Claimants is to pursue their grievances through the CCRC and/or the criminal appeals courts, not the GLO, until such time as their criminal convictions have been overturned.
24. According to Brian Altman QC, the only proactive duty Post Office has is to ensure that the appropriate disclosures are made to each convicted individual. It may be that findings are made in the Horizon judgment which require Post Office to make fresh disclosures which convicted parties might then be able to rely upon to found criminal appeals. Brian Altman QC has advised that, if fresh disclosures are required, an individual case-by-case review will need to be conducted to determine the appropriate approach in each case.
25. Against this background, settlement with the convicted Claimants raises particular challenges:

¹¹ See, for example, the case of **GRO** (Claimant 444) who admitted in interview that she had inflated cash figures and falsified branch trading statements; that she had "borrowed" Post Office funds and was unable to repay the funds; and she had taken cash from Post Office to pay it into her business account - the money was used to pay for shop, wage and household bills.

¹² See, for example, **GRO** (Claimant 248) case where the charge of theft (1 count) was not pursued following a guilty plea to false accounting (7 offences). Similarly, the charge of theft against **GRO** (claimant 178) was not pursued following a guilty plea to false accounting (3 offences).



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- a. The convicted Claimants, who are Post office's most vocal critics, are likely to form a core component of the Claimant committee at the mediation. If Post Office were to take an inflexible position that their claims cannot be considered as part of the mediation process, there is a high risk that the mediation will not get off the ground. Post Office is also likely to be subject to trenchant public criticism, as happened at the time of the original mediation scheme in 2013.
- b. However, settling with the convicted Claimants is problematic:
 - i. It is not a principled way of proceeding. If a Claimant has been properly convicted, it is in the interests of justice that the conviction stands (from our review, it appears that several convicted Claimants admitted to theft of Post Office funds). If, on the other hand, a Claimant has been wrongfully convicted, he is deserving of the maximum compensation. No obvious half-way house exists.
 - ii. Any settlement could be viewed as admission of failures on the part of Post Office in the exercise of its prosecutorial powers, which is a serious matter. If Post Office has got things wrong, it should of course address that. However, given that an admission of any such failing will have consequences,¹³ this is not a step that should be taken lightly.
 - iii. Brian Altman QC's advice is that offering the convicted Claimants anything at all would of itself enhance the prospects of the Claimants succeeding in their appeals (confidentiality over the settlements could not be maintained). It also risks unravelling the numerous other prosecutions where Post Office acted as prosecutor.

26. In light of these complications, Post Office must take a strategic decision as to whether to exclude convicted Claimants from the settlement discussions or take a non-legal approach and seek to settle with these Claimants notwithstanding the risks. There is no wholly satisfactory solution. Having given the matter careful consideration, we consider the best approach is not to make any settlement offers to convicted Claimants.

¹³ Not least the risk of a potential re-examination of all its past convictions – a difficult exercise in light of the passage of time - as well as the increased civil claims.



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That would not, however, preclude Post Office from making a global settlement offer to the cohort of non-convicted Claimants. If the wider Claimant group then agreed to apportion that lump sum amongst themselves, that would be a matter for them.

Assistants

27. There are 28 Claimants who are Assistants (rather than SPMs). Assistants fall into a distinct category because, under the Common Issues judgment, they have no third-party contractual rights and therefore no claims against Post Office for breach of contract (for example, for lost earnings). Such claims might be brought through SPMs but, in a number of cases, the Assistant's SPM is not a claimant in the GLO.

28. Assistants would not be precluded from claiming in restitution (for shortfalls repaid) or in tort (for harassment, personal injury and so forth). Several assistants were convicted and, if their convictions are overturned, they may have some prospects of succeeding. For those that were not, however, these claims appear speculative.

Settled Claimants

29. Approximately 150 Claimants settled with Post Office either under the Mediation Scheme or under one of the Network Transformation restructuring programs and entered into full and final settlement agreements. A sympathetic judge may be persuaded to unwind those settlements on misrepresentation grounds. However, even in that event, Post Office has a good argument that credit should be given for sums that it has already paid.¹⁴ Network Transformation Leavers were, for example, paid relatively substantial sums, roughly equivalent to 26 months' earnings.

Summary

30. In summary, therefore, while we can identify some weak claims or categories of claims within the Claimant cohort, this is not a case where we consider there are likely to be strong arguments on liability across the board. Post Office's position may improve¹⁵ if

¹⁴ There is a partial exception for Claimants who converted under the Network Transformation programme whose settlement releases do not cover claims in respect of Post Office activities going forward.

¹⁵ Even if the judgment is overturned, there is still a strong probability that claims will fail on the facts, particularly if the Horizon judgment is unfavourable.



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the Common Issues Judgment is overturned, but our present assessment is that Post Office is unlikely to get permission to appeal on many (if any) of the good faith terms which go to liability issues and the hearing of any appeal is unlikely to take place until mid or late next year. Further, although many of the claims are old, **REDACTION**

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Quantum

31. **REDACTION**

32. **REDACTION**

Post-Termination Losses

33. **REDACTION**

34. **REDACTION**



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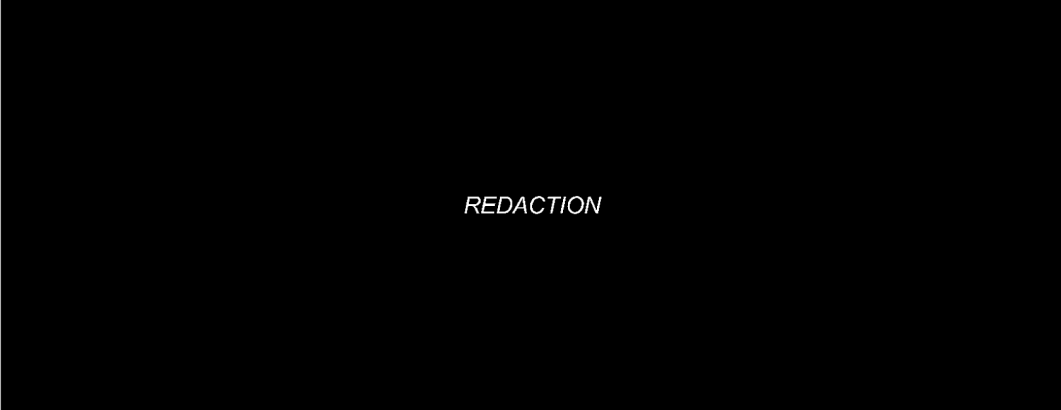
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Funding Cost Claim

39. The new claim advanced for the recovery of the premium payable by the Claimants to their litigation funder is also likely to be very substantial. We do not, however, consider that it is likely to succeed. The law is clear that funding costs are irrecoverable as costs and it would be extremely surprising if the Claimants were permitted to circumvent that rule by re-framing the claim as one for damages. It is also contrary to the public policy on litigation funding that was recently examined in the context of the Jackson reforms.

Quantification Models

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43.

Ground-up recoverability analysis

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Non-convicted Claimants (494 Claimants)

45. [REDACTED]

46. [REDACTED]

47. [REDACTED]

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Convicted Claimants (61 Claimants)

48. [REDACTED]

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49. REDACTION

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Costs of "fighting and losing"

52. REDACTION

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Recommended Settlement Range

56. Seen in the round, we consider that a settlement of £40m - £65m would be a good price to pay for the settlement of this litigation with the non-convicted cohort. We say so for the following reasons:





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57. A helpful sense check as to whether these numbers are in the right ball-park could be to consider the average value of a Post Office business. The average SPM remuneration across the Post Office network (i.e. not limited to Claimants in the GLO) stands at circa £38,000 per annum. We note that leavers under Network Transformation were offered 26 months' earnings by way of an exit payment. If that is taken as a proxy for the value of a the loss of an average Post Office businesses, that would suggest the average value of a branch business would be of the order of £82,333, or a total of **£45.7m** across the 555 Claimants.

Settlement Strategy

58. The Claimants' settlement expectations are unlikely to be driven by strict legal analysis. As a practical matter, we anticipate that the Claimants will want to recover their full funding costs (typically a multiple of costs invested) and a top-up payment which allows each Claimant to receive a meaningful (albeit proportionately reduced) recovery on top.

59. We have no visibility as to the Claimant Group's funding arrangements but estimate that they may look to recover £75.9m - £90.9m for their legal costs and expenses at a settlement in November 2019.²⁰ Given the burn rate on costs, this would likely increase to £90.9m - £109.9m at a settlement in May 2020. If each Claimant were also to recover between £10,000 and £50,000 in addition, those numbers would increase to £81.4m - £118.7m as at November 2019 and £96.4m - £136.7m as at May 2020.²¹

60. If our estimates are accurate, there will be a gap between the parties with the result that settlement is unlikely to be achievable given the weak negotiating position Post Office is presently in. Post Office therefore needs a clear strategy which preserves its

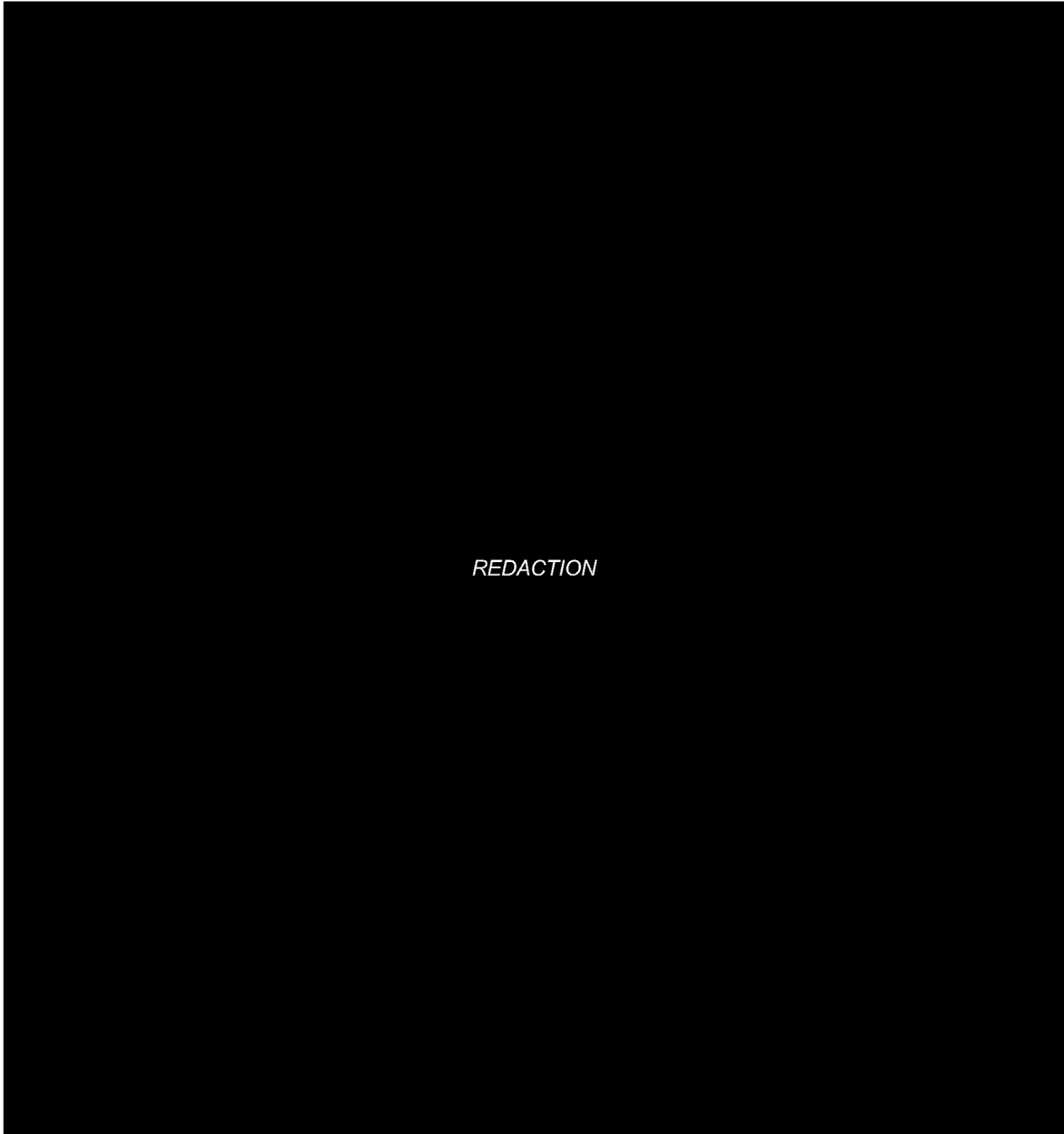
²⁰ This is calculated as 3 – 4 x estimated costs incurred to date, assumes that Freeths is on a 100% CFA and assumes an ATE premium of circa £6m was paid.

²¹ Post Office's Board has quite properly observed that, given our assessment of the likely recoverable quantum, it is unclear why the funders agreed to invest in the claim. That is a pertinent question. It seems to us the most likely answer is that the Claimants have exceeded their original budget – possibly by some considerable margin – because they did not anticipate that Fraser J would order quite so many trials and that quite so many contentious issues would arise. It may also be that allowance was made for recovery by all 61 the convicted Claimants and/or for interest at higher rates.



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prospects of achieving a reasonable settlement later down the line if the November mediation fails. Our recommendations are that:



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- c. Going forward, Post Office will also need to maximise pressure on the Claimants by re-focussing the litigation on points where the Claimants are more vulnerable, including careful selection of test cases which would enable Post Office's best points to be brought to the fore.



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Potential Claimants outside the GLO

61. [REDACTED]

62. [REDACTED]

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Herbert Smith Freehills LLP
12 November 2019

²² Under section 32 of the Limitation Act (1980), time will start to run again once the Claimant "has discovered the fraud, concealment or mistake (as the case may be) or could with reasonable diligence have done so".



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Appendix 1: Breakdown of Claimants' Claims

Head of loss	Total Claim Value
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Appendix 2: Ground-up Recoverability Analysis

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Appendix 3: Breakdown of Ground-up Recoverability Analysis



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