

The Background to Recusal and other issues

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Context

The Board is meeting to decide whether to apply for the Judge in the GLO to recuse himself from the proceedings on the grounds of apparent bias. The Board requested a broader paper setting out the litigation strategy and the wider implications for the business, putting this decision into context.

Through this paper, we have considered impact through three lenses: the current claimants; the risk of future claimants; and the risk to ongoing operations.

We have also considered three core outcomes: the original legal strategy, working through the four trials with a Judge that we would consider neutral; the original legal strategy played through with this Judge following the recent judgment; and settlement.

Questions

The questions we are seeking to answer are:

- We went into this litigation believing we were fundamentally “right”. Given the Judge’s criticisms, do we still feel that is the case?
- What is the range of outcomes we now see?
- Do we believe an appeal is appropriate?
- Do we believe recusal will make things better or worse?
- What are the implications for the CCRC?
- What decisions are coming up?

Conclusions

1. We believe that our systems and processes work today. It is of course harder to demonstrate that they worked 10 or 15 years ago. We do believe that the way we work doesn’t always get the balance right between us and Postmasters and there are times when the tone can be too self-serving. Strategies to address that are underway and will be accelerated.
2. Where the claimants formed part of a previous mediation process, our people have worked through cases and believe that where we reached a settlement, justice was served. However, some 450 claimants are new and we have not had the opportunity to re-assess them.
3. In our original strategy, working through the 4 trials was expected to cost us £25-30m¹ in legal fees with the possibility of an earlier settlement reducing the trial costs. This strategy would have resolved the ‘big’ questions such that there would have been little incentive for further trials with new claimants, and our own plans to improve operational processes would have been sufficient to correct the legacy issues.
4. With the result of the first trial and the current Judge, high level estimates are very much worse. The cost of the current litigation (including potential awards of damages and costs against us) could be over £100m, and we could see a significant

¹ On top of that, significant costs (c£12m) were incurred prior to the commencement of the litigation taking the total to over £40m.

contractual challenge from other postmasters enabled by the new contractual interpretation, adverse findings on Horizon, and a rejection of any limitation arguments: potentially a further c£70m and we will incur operational costs of c.£5m a year. Total costs could get towards £200m and in the event of a very adverse Horizon verdict we may struggle to maintain 11,500 branches. Overall, we might need Government support in this outcome.

5. If we were able to reach a settlement, the cost of the current case might be less (£50-70m) but future claimants and operational changes would be unaffected.
6. Given the strength of our legal advice, we are therefore likely to recommend an appeal on contractual interpretation to limit the cost both of this case and any future case.
7. Recusal is the subject of this meeting and separate papers have previously been shared. A separate call has also been set up for those Board members who are available to discuss it with Lord Grabiner QC. Clearly, a successful recusal would give us a chance to fight again and reduce the risk of an adverse Horizon judgment.
8. The CCRC is not expected to announce findings until after the GLO is complete, however adverse findings on the contract and Horizon may well have a detrimental impact on their assessment as to whether there the cases under review had been properly prosecuted.
9. Recusal has to be decided and, if approved, implemented this week. We now have until 16 May to lodge an appeal against the judgment. Operationally we have a number of workstreams underway with some urgent priorities and some substantial decisions to come.

Input Sought

The Board is asked to note the report, commenting and requesting further information as appropriate, and make a recommendation as to the application for recusal.

The Report

Are we right?

10. Much of our effort across the litigation has been to demonstrate that our business "works": the systems work; our processes work; we apply them in line with our contracts and so on.
11. We have never suggested that we don't make mistakes or that there has never been an individual miscarriage of justice. However it is clear that historically we have taken a very black and white interpretation of the contract with an intense focus on protecting our cash, and with an implicit, and possibly institutionalised assumption that any losses must be due to 'operator errors', and which we therefore expected the postmaster to make good. This also meant that some postmasters were prosecuted and the CCRC is reviewing approximately 30 cases to determine whether those convictions were sound.
12. The Complaints Investigation and Mediation Scheme ("Scheme") set up in 2013 and which came to an end in 2015 reviewed all 141 cases in the Scheme and offered mediation. The outcome of these reviews – including by Second Sight, did not identify any systemic problems with Horizon, but demonstrated that in many cases we did not provide appropriate training or support. One of Second Sight's key criticisms was that we did not sufficiently investigate losses in branch. The mediation failed overall – participants in the scheme withdrew support in part due to the fact that many of them had unrealistic expectations of the financial outcomes.
13. In recent years, we have chosen not to prosecute cases which relied on evidence derived from Horizon. However, we have said would like to, as we have seen losses increase from £2m a year to £5m as a result of the change, in spite of a lot of work to manage the issue.
14. The legal strategy has therefore reflected a belief that we can reach the right conclusion in individual cases, that we need to protect the business and that the systems work.
15. The current claimant population is approximately 560 strong, but they are not an homogenous group. There are approximately 150 former Postmasters who have joined the litigation in spite of having agreed a full and final settlement either under the Scheme, or under Network Transformation where they received exit payments of up to 26 months' pay. Clearly, in these cases we believe that justice has been done.
16. However, there are also some 450 claimants who joined the litigation after the closure of mediation and we do not yet know whether they deserve some restitution or not. The position on the individual claimants is therefore uncertain.
17. On the "does the system work" question, we believe that Horizon works today. We process some 0.5b transactions through it every year and manually correct less than 100k. Many of those transaction corrections are caused by errors by Postmasters which are easily resolved and for which they are not liable.
18. We settle with commercial clients based on Horizon transactions and whilst each client is different, if we were systematically failing to process transactions with banking customers or bill payment clients accurately, then the mis-match with

their own customers would generate significant noise and attention. We do have differences. We have a team of 7 in Chesterfield whose job it is to correct banking differences but the number is limited and the vast majority reflect obvious errors around counting the cash (picked up by the second count in Supply Chain) or mis-keying. We are not seeing anything that suggests a system flaw.

19. In addition, on appointment the Chairman commissioned an independent review from Deloitte to look into this question. While it was overtaken by the litigation, we are not aware of any materially adverse findings.
20. Obviously, this does not mean that our systems and processes worked in the same way 10 or 15 years ago: that is extremely hard to demonstrate.
21. In our current strategy, we absolutely believe we need to go much further in how we manage the relationship with agents, shifting from managing our own issues first to supporting a partner. This encompasses a lot of different changes some of which are underway and others will need to be accelerated. The point of stressing it here is that we do not yet believe we are in the right place culturally and in the way we work.
22. In conclusion, we would say that the systems work but that the way we deal with our Postmasters can be further improved to demonstrate fairness and to ensure we cannot be accused of onerous behaviour.

What is the range of outcomes?

Original Strategy

23. Our original strategy was based on demonstrating that:
 - the burden of proof in cases of difference largely rested with the Postmaster because only he or she could know what had happened in branch;
 - the systems and processes fundamentally work and worked during this period;
 - any specific bugs or issues did not cause losses of the sort that are being claimed, mainly because they were identified and Postmasters weren't held liable;
 - the claimants include people who started a claim after the normal 6 year limit, or had already settled and therefore the true number of claimants is much smaller; and
 - any legitimate claims could therefore be resolved in accordance with normal principles.
24. Assuming this strategy was successful, we could envisage a further £10m of legal costs in 2019-20, £1-5m of specific payments and perhaps £5-10m if we lost on notice periods. A total cost of £20-30m plus some possible costs against us. In the January Board we set out change plans that assumed we would retain £30-50m to cover the GLO outcome.
25. If this was the outturn, we might not expect a significant body of additional future claims: the trial process would have been long and expensive, but would have addressed the core challenges relating to the contract and Horizon, such that individual cases could then be considered.
26. Clearly, there would have been limited impact on our operational processes and our agent strategy would improve matters in future beyond any legal or contractual requirement.

The original strategy with the current judge and recent judgment

27. Clearly, the original strategy appears severely damaged for two reasons: we lost on the contractual interpretations; and the Judge is presenting himself as someone who believes we are conspiring to hide an injustice, appearing to believe that there are fundamental flaws in Horizon; that we know this, and are trying to hide it.
28. In this scenario, the £20-35m estimate must look light. We should assume that the Judge would link his conspiracy perspective and deny legal limitation in the third trial. This will also enable future claims. Clearly, for all the claimants, the way we work now will be in breach of the new contractual interpretation.
29. It is very hard to even guesstimate how this would work through financially. We know that the funders will receive a significant proportion of any claim. In 2016 we believed that this was the first £20m of any award or settlement, however in light of the legal costs that they have now funded plus a private equity margin, it seems likely that this amount would now be higher- perhaps in excess of £30m. Therefore a calculation based on each claimant receiving £50k (500 claimants @£50k = £25m) would mean that after the lawyers and funders' costs that the actual claimants would receive relatively little; so their expectation must be for an average award of closer to £100k per claimant – which would be c£50-60m in total, on top of our own legal costs, and a contribution to theirs. On this basis a total bill of at least £80m is foreseeable before we add on the operational impact. For financial planning purposes we are working on £100m so that we have a significant margin for error should our estimate of claims be too low.
30. More worryingly, this outcome (whether achieved via court processes or a settlement) would open the door to material future litigation: if the verdict stands then anyone who has been required to repay losses, been suspended, terminated or who has resigned rather than return cash will be able to argue that the way we have dealt with them was in breach of our contract, as now interpreted. Whether this takes the form of litigation or some form of "PPI" equivalent scheme remains to be determined.
31. We haven't tried to assess this as a potential cost – but say 1,000 agents (we suspend c. 100 a year) at £50k each is another £50m plus legal costs–So we could be at risk for a further £70m and this takes us into the territory where we might need further Government support.
32. In terms of ongoing operations, we are already working through how we behave in a manner that is consistent with how we want to work with agents and the new contractual interpretation. It is early days and it includes an opportunity to be a better business, accelerating work we wanted to do anyway. We could assume £10m of one-off costs and £5m a year on higher run costs in more people in the field and higher losses.
33. Our greatest threat however is if the Judge finds a way of saying that Horizon wasn't, or isn't, reliable. He shouldn't do so – both expert witnesses have said that they agree that the system is "relatively robust". However, recent experience suggests that the Judge may reach beyond this. That decision will be essentially a question of fact and therefore is unlikely to be appealable. This could shape or undermine confidence amongst our agents, our suppliers, our clients and our people. Of course, we would seek to manage that but it could seriously undermine our ability to maintain a network of 11,500 branches and meet customer expectations.
34. So the total cost over the next two years could easily exceed £150m combined with

the failure to meet our core targets. We would struggle to afford that without further damaging the business or getting substantial, additional support.

Settlement

35. Within our strategy, we had assumed there would be moments when we could and probably would settle. The first of these is this Summer: following the Horizon verdict both sides are required to go through a period of mediation.
36. Settlement would bring this trial to a close and while there would be some brand damage from doing so, it would be relatively time limited. In light of the recent judgment there must be a risk that a settlement would cost us a similar amount to the figures set out in paragraph 29 and there will still be a material risk of claims from other current and former postmasters who are not part of The Claimant Group; as set out above, there will be many more of these.
37. Settling before the verdict on the first trial would have left contractual interpretations uncertain, and the challenges around Horizon itself unresolved, as well as not resolving the issues of anyone outside the claimant group. That was costly and not desired. However, given the verdict we have, the uncertainty may have been preferable especially when considering the risk of future claimants.

Do we believe an appeal is appropriate?

38. Our legal advice strongly supports an appeal on the contractual interpretation: our advisors, including a former President of the Supreme Court, believe we have at least a reasonable chance of success, overturning a bad legal judgment. Clearly, all pre-court advice is uncertain. The cost of an appeal would be c. £1m. Appealing on the points of law is consistent with our public statement and the letter from our Minister.
39. A better outcome on appeal would be materially desirable. Firstly, it should reduce the ultimate cost of reaching resolution with the current claimants, including reducing the likely cost of settlement. Secondly, it makes both a new case and further material losses from new claimants less likely. Thirdly, it gives us more flexibility to make the operational changes we think right rather than being guided by this interpretation.
40. On that basis, we recommend an appeal on the contractual variations.

Do we believe recusal will make things better or worse?

41. The Board has seen a separate paper on recusal with advice from Lord Neuberger and an opportunity is available to discuss it further with Lord Grabiner ahead of the Board call. We will not rehearse the arguments again here. A successful recusal would mitigate against another unfair verdict on Horizon and any subsequent trial would be expected – but not guaranteed – to produce a better outcome for the litigation and for any subsequent settlement.
42. Further, as flagged by Lord Neuberger on the call last night, making the application for recusal – even if not successful, will assist an appeal on the grounds procedural unfairness.
43. In re-trials and in further trials we should review our tone and approach to ensure we don't create the same reactions again.

44. Clearly, it is uncertain whether an unsuccessful recusal would antagonise the Judge further or make him more cautious.

What are the implications for the CCRC?

45. The CCRC's views are not known and we do not expect them to reach a conclusion on a potential miscarriage of justice in the 30 cases under review until after the Horizon trial is concluded and the judgment handed down. The effect of the judgment as it stands probably means that the branch trading statement would not now be held to have been proper evidence of loss, and we are more likely to have been in breach of contract such that there would be a greater risk of the decision to prosecute not having been justified. If the Horizon trial also has an adverse outcome, then it is highly likely that the CRC will have to review their conclusions. While we are still unsighted on these, the risk of an adverse outcome from the CCRC must now be significantly higher.

What decisions are coming up?

46. We have to reach a decision at this meeting on whether to ask the Judge to recuse himself, and to appeal if he disagrees, and to make the application this week.
47. Normally we would have some 21 days from last Friday to request leave for appeal, detailing the basis of such an appeal. At this stage the judge has indicated that consequential orders will be made on 16 May, and that would be the point at which we would seek leave to appeal.
48. We have to respond as a business. We have a number of workstreams underway as follows:
- Legal (Jane)
 - Operations (Julie Thomas)
 - Agents (Amanda Jones)
 - Communications (Mark Davies)
 - Stakeholders (Al and others)
 - IT/Horizon verdict (Rob Houghton)
 - Brand (Emma Springham)
 - Financials (Micheal Passmore)
49. Many of the workstreams have immediate priorities and then longer term questions and we will need to be alert to changing circumstances and trends. The most urgent questions are around how we operate now in terms of signing up new postmasters, how we should deal with differences and how soon we could introduce reasonable contract variations that protect us and clarify things for Postmasters in future.
50. Beyond immediate working patterns, we need to determine how far we want to go and how quickly as we accelerate our strategy of making it easier for Postmasters. This is underway and to reassure the Board on this, our draft budget already assumes a net investment in the Retail field teams to improve face to face contact, the development of the branch hub, plans to reduce errors and repeats, the operationalising of the work we have done to create a data set for each branch to highlight issues that can then lead to training or other support and efforts to change the tone from audit and fraud to support and partnership.

51. However, current plans are not enough and in particular the process to manage differences will need to be very carefully designed, implemented and overseen and we will have to decide how much independence we want to introduce into the process. Transparency will be critical. This is also relevant for our work with the NFSP which forms part of the agents' workstream.
52. We then have choices to make about whether now is a good time to make some deliberate shifts in "fairness" between us and Postmasters. Should we resolve the stuck Postmasters issue, either by getting permission to miss 11,500 or by putting our own staff in, albeit under new contracts? Have we got the profit share right on Banking Framework 2 income? And so on.
53. We are planning to revert to the Board with recommendations before end April.
54. By that time, we must have a clear plan for managing an adverse Horizon trial verdict and a plan for a mediation process.
55. We are also updating our longer term view of our financial situation and the availability of funding. We have a number of workstreams already underway to optimise funding: offering to buy our way out of Santander security; requesting Bank of England help to improve funding available from the NCS arrangement; potentially requesting slower payment terms from banks etc. We will cover these at the Board meetings in May and July but none of them are straightforwardly in our gift.