

LEGALLY PRIVILEGED AND CONFIDENTIAL

Update on the work programme arising from the Horizon report

1. Further to the Board discussion on 16 July, this note provides an update on how we're taking forward the programme of work in response to the publication of the Second Sight report.

Outline of the key workstreams

2. Our work programme is split into the following four broad categories:
 - i. completing the review of cases started as part of the Second Sight investigation, with the aim of seeking some form of resolution;
 - ii. meeting our duty to review cases that have been subject to criminal prosecution;
 - iii. identifying improvements in the training, support and other processes related to the Horizon system and branches; and
 - iv. meeting our commitment to review how an independent safety net could be introduced to help resolve disputed cases with sub-postmasters in the future.
- i. Completing the Second Sight case reviews
3. As was evident at the Parliamentary debate on 9 July, there is a clear expectation from all the key stakeholders concerned – the JFSA, James Arbuthnot and other MPs – that the existing 47 cases which have been submitted to the Second Sight process would be properly reviewed, with the aim of seeking some form of resolution in each case. There was also a clear expectation from MPs that Second Sight would continue to have a leading role in this process, in order to guarantee independence from the Post Office.
4. We have therefore been focussing on developing an approach to respond to these expectations which balances the requirements to be cost effective, time efficient and credible. We have two specific concerns around Second Sight's role in this context:
 - a) as a two-man team they do not have the capacity to deal with all of these cases within an acceptable timescale; and
 - b) their approach of seeking to reconcile the conflicting evidence and views of the Post Office and sub-postmasters – which stems from a steer from James Arbuthnot that they needed to “keep the JFSA onside” – is pushing them into an almost impossible situation, which both extends the time taken to conclude each case and, more worryingly, creates a tendency for them to place greater weight on the sup-postmaster's version of events, irrespective of the evidence we present.
5. We propose to address these concerns through two specific measures:
 - restricting Second Sight's remit to the specific task of preparing an impartial evidence base, with no requirement to seek to iron out any inconsistencies between the two sides' positions. We propose

LEGALLY PRIVILEGED AND CONFIDENTIAL

that this process of resolution will instead be pursued by employing an independent professional mediator, who will seek to facilitate a dialogue between the Post Office and sub-postmaster to arrive at a sensible conclusion; and

- changing the way we work with Second Sight, by allocating additional senior level resource with a deep understanding of the network to work closely alongside them, in order to answer their queries and help them prepare an accurate evidence base as quickly and efficiently as possible.
6. The mediator (or panel of mediators) is likely to be a senior, independent lawyer, with specific experience and expertise in mediation. His or her role will be to help the sub-postmaster and Post Office find common ground and hopefully some form of resolution to the sub-postmaster's complaint. They would not have the authority to impose a financial settlement or any other form of resolution on the parties.
 7. There are a number of possible outcomes to this resolution process, which will have to be determined on a case by case basis. In some instances we may conclude that we still believe that the sub-postmaster was at fault, and therefore no specific redress should be offered. In other cases we may acknowledge that there were shortcomings on our side or both sides, and commit to take action to address these as part of the process improvements workstream. And of course there is the clear risk that in some cases the sub-postmaster will argue that financial compensation is appropriate, which again will have to be assessed carefully on a case by case basis. We certainly do not believe there are grounds for a blanket compensation scheme, and will not be setting up the process with this expectation. Further details of the potential claims for compensation are provided at paragraph 25 under the Costs section below. If agreement could not be reached through mediation, the sub-postmasters concerned could still seek remedies through the civil courts.
 8. We discussed the broad concept of mediation with James Arbuthnot (and Second Sight) on Monday and he was supportive in principle. We then followed this up with a detailed workshop on Thursday with Second Sight and the JFSA to agree the specific details of the process. It was decided that a working group should be established to provide independent oversight of progress, which is also in keeping with the commitment we made in our 8 July statement. As a minimum the working group will comprise representatives of the Post Office, JFSA and Second Sight, although we may also invite other stakeholders and/or appoint an independent chair. One option which we will explore next week would be to invite BIS to participate, to represent the interests of taxpayers in ensuring that public funds are used appropriately – although they may be unwilling to play this role.
 9. It should be noted that while we believe this process will result in a swifter (and more robust) result than if Second Sight were tasked with resolving all the cases by themselves, it will still not be a quick process overall. Our best estimate at this stage is that it will be early next year before all the existing cases currently in scope can be resolved (although in the meantime we will be drawing a line under individual cases at a steady pace and thereby helping to dampen the 'noise' and reputational risk related to the issue). There will also be additional costs involved with mediation, as set out in more detail at paragraph 24 but as explained below it is not clear that there is a more cost effective and viable approach to dealing with the legacy of past cases.

LEGALLY PRIVILEGED AND CONFIDENTIAL

10. The alternative option would be to seek to set a fixed deadline for Second Sight to complete their work (e.g. October), and set them the task of reviewing as many cases as they can within that time available. However, we do not believe this would be credible or in the best interests of the business overall. Second Sight have indicated that, under the current working arrangements, they would only be able to process a handful of cases within this timescale. James Arbuthnot made it very clear to us that he was prepared to take strong action through Parliament and the media if we sought to close down the process in this way and leave some cases unresolved. We know he would be supported by other MPs in this regard, and likewise the JFSA has lobbied Jo Swinson directly on this point. We therefore reached the conclusion that it would expose the business to unacceptable ongoing reputational risks to ignore these concerns.
11. We also considered the option of supporting Second Sight with additional capacity from another firm in order to seek to accelerate the rate at which they can process cases. However, this would not address the underlying issues associated with their current role of seeking 'resolution' between the two sides' accounts, which forces them into a conflict of interest and stymies their ability to make progress. We therefore concluded that the mediation process, alongside more collaborative joint working and no arbitrary time limit, would be the best way to balance our various objectives.
12. The independent mediation approach has clear benefits in communications terms – providing a tangible sign of the Post Office's determination to take these issues seriously and respond appropriately. This has the potential to take some of the sting out of the issue as a media story. This process will be supported by a specific programme of engagement with each of the relevant MPs (and other stakeholders) to keep them on side as far as possible.
13. As we flagged up in the last Board paper, there is a strong likelihood that other historical cases will emerge as a result of the media and Parliamentary attention arising from the interim report. Alan Bates of the JFSA has since confirmed that more sub-postmasters have approached him over the past two weeks. We therefore need to consider how we address these. We do not believe that ignoring them is a credible option, so we are instead working constructively with the JFSA to develop an impartial filtering process to decide whether any of these cases should be referred to the mediation and resolution process noted above.

ii) Prosecution Case Review

14. There is a separate process in train for those cases which have been subject to criminal prosecution. As we discussed at the last Board, as a prosecuting authority we have a continuing duty to act properly and fairly, and that requires us to disclose to the defence any information which undermines the prosecution. This assessment is made on a case by case basis. Through our criminal law solicitors, Cartwright King, we are complying with this duty by reviewing past and present prosecutions to identify any cases where the Second Sight report ought to be disclosed. It is then up to the defendant to decide whether to apply to the Court of Appeal for permission to appeal a conviction based on the additional information.
15. As of 22 July, Cartwright King had reviewed 124 cases, with the following outcomes:

LEGALLY PRIVILEGED AND CONFIDENTIAL

- the prosecution has been discontinued in three cases as not being in the public interest;
 - disclosure to the defence has been provided in 6 cases;
 - in all cases, the recommendation is that we oppose any attempted appeal; and
 - it is not believed that any of the cases would satisfy the test for compensation from the Government for a miscarriage of justice under Criminal Justice Act.
16. The next step will be to review pre-separation case files held by Royal Mail, initially dating back to the start of 2010.
17. We are also consulting Brian Altman QC, a leading barrister and former First Treasury Counsel, to provide additional advice and independent oversight on this case review process and any wider criminal law questions that arise (for example questions from the Criminal Cases Review Commission about how we are handling this matter). Counsel's scope of work will also include recommendations about our future prosecutions strategy, to inform our own thinking.
- iii) Process improvements
18. As we discussed at the Board, there is a clear opportunity emerging from the Second Sight review to make substantial improvements to the way we train and support sub-postmasters, which should have a lasting beneficial impact on the business. We have therefore appointed one of our most experienced senior managers, Angela Van Den Bogerd, to lead the overall delivery of this workstream. She will be supported by a programme board bring together relevant expertise across the business, to take forward work under the following areas:
- Audit – the process of undertaking on site cash and stock verification and transaction and procedures compliance and conformance.
 - Training – new entrant classroom and on-site training for Crown staff, Spmr's and their staff. This includes training on balancing the branch accounts.
 - Field support – how we support Spmr's in branch or indeed remotely when they have problems with transactions and accounting difficulties including not being able to balance their branch and error notices (transaction corrections)
 - Contracts – how we award contracts for services to Spmr's; how we monitor performance once contract awarded; how we deal with potential contract breaches including our policy on precautionary suspension and either termination of contract or reinstatement of the Spmr.
 - Security – how we investigate what appears to be a breach of contract and/or potential criminal activity at branches e.g. fraud, theft
 - Helplines – the provision of product and services advice and guidance and assistance with first line problems/queries on transactions; accounting and use of the Horizon system.

LEGALLY PRIVILEGED AND CONFIDENTIAL

- P&BA – the identification and processing of errors by branches. Support is given to Spmrs in understanding accounting errors and how to prevent the error going forward. Transaction corrections are issued from here.

19. This programme of work will be informed by two inputs in particular:

- any insights emerging from the case reviews, enabling us to demonstrate that we are responding to the key learning points from this process; and
- a new 'Branch User Forum', which will be a permanent structure that provides a means for sub-postmasters to provide direct feedback into the business on the way we train and support them. We are now in the process of scoping the membership and terms of reference for this forum, with the aim of holding the inaugural meeting in early October.

iv) Adjudication/mediation for new cases

20. As part of our response to the Second Sight report, we committed to establish "a review chaired by an independent figure to determine how an independent safety net might be introduced to adjudicate in disputed cases in the future". This was in part informed by a proposal which Alan Bates submitted to us and James Arbuthnot, although it also mirrored our own thinking on the need for such a mechanism.

21. Based on the initial advice we have received from our external lawyers on the use of such mechanisms in other businesses and industries, our view at this stage is that this commitment is best taken forwards by extending the process of mediation that we are seeking to use to resolve the existing Second Sight cases. This would be more appropriate than an independent adjudicator, which works best when clear judgements can be made against a rigid set of rules. The nature of our disputed cases with sub-postmasters requires a more nuanced approach and process of dialogue, and therefore mediation is likely to be the more appropriate mechanism.

22. Our initial view at this stage is that the remit of the Working Group noted in paragraph 8 above may be extended to conduct the review of these arrangements, building on the experience of the mediation process which we are establishing for the existing Second Sight cases.

Governance and leadership arrangements

23. The overall programme will be led to Susan Crichton, reporting to a weekly steering board chaired by CEO and attended by other relevant directors including the CFO. This steering board will report to the ARC on progress, alongside regular updates to the Board.

Costs and business risks

24. The project has so far incurred spend of £220k related to Second Sight's costs. The table below sets out our initial estimate of the potential further costs that are likely to be incurred through the next stages of the programme, which could total in the region of £0.9-1.4m (not including any costs associated with compensation). Clearly these estimates are subject to considerable uncertainty at this

LEGALLY PRIVILEGED AND CONFIDENTIAL

stage, although we will be taking every opportunity to minimise the risks of additional expenditure. The overall programme will be closely monitored by Finance, with any policy decisions with the potential for substantial costs subject to the approval of the CFO.

Area	Estimated costs	Commentary
Second Sight (or replacement)	£100-150k	Will be managed within fixed fee or on fee per case basis, with close monitoring to ensure delivery of outcomes within this budget. Doesn't include £220k already spent
Costs of mediation	£350-550k	Assumed cost per case is £6k. Key uncertainty at this stage is how many cases beyond the initial 47 will pass through the filtering process. This estimate is based on 75 cases each requiring a half day of mediation.
Costs of external legal advice	£100-300k	Includes QC, Bond Dickinson and Cartwright King
Independent Chair	Nil to £10k	May be an unpaid post
Process improvements and IT changes	£200k	Dedicated team of 5 people. Horizon development costs assumed to be covered within £100k budget which Fujitsu has offered to set aside. Expenditure in this area should be viewed as adding value to the business, by strengthening sub-postmasters' capabilities and reducing occurrence of future problems.
Helpline	£40k	Dedicated team of 3 people
Finance Service Costs	£100k	Dedicated team of 2 people providing data on specific cases
Total	£0.9 to 1.4m	

25. As indicated at paragraph 7, in cases where through the resolution process we concede that shortcomings in our processes were a significant factor in the difficulties faced by sub-postmasters, they may seek to claim some form of compensation. The mediator would not be empowered to impose any form of financial settlement, so it would be up to us to consider the most appropriate response, which will have to be determined based on the individual merits of each case. This assessment will need to take into account the risk that the sub-postmaster could successfully secure compensation through the civil courts, alongside a consideration of what we deem to be our moral responsibilities as a principled business and our exposure to damaging reputational risks. Given the uncertainties, at this stage it is not possible to provide any meaningful estimate of the potential overall costs associated with compensation, although we will be keeping this under close review. However, to provide a sense of the range of potential claims in individual cases, possible types of compensation might include:

- for early termination / forced exit cases - 3 months remuneration (as per standard notice period in the sub-postmaster contract);
- for claims of distress and reputational damage - hundreds of pounds up to tens of thousands of pounds;
- repayment of wrongful losses (i.e. where a sub-postmaster was forced to settle losses which were later found to be false) - this will of course depend on the size of the debts in each case; and

LEGALLY PRIVILEGED AND CONFIDENTIAL

- there will also be a mixed bag of other losses such as legal costs, forced insolvency and loss of retail business, which are very difficult to predict.
26. If we were to reach an agreement on compensation through the resolution process, it is likely that we would ask the sub-postmaster to sign an agreement waving all their claims so we have some finality and are not exposed to further risks through the civil courts.
27. While it is clearly uncomfortable to be entering into this resolution process without a clearer sense of the likelihood and potential quantum of compensation that might arise in some cases, it should be noted that effectively this contingent liability already exists, and is the product of legacy shortcomings rather than the resolution process itself. We will of course be seeking to manage the process in a way which arrives at a sensible and proportionate outcome to each case, taking into the wider public interest of taxpayers and not just the individual sub-postmasters. We have considered whether we could limit our exposure by setting a limit on the amount of compensation payable for each individual case or the caseload as a whole: however, our concern is that this will only serve to increase costs by setting an expectation that compensation is payable in every case rather than by exception.
28. There are a number of other potential business risks which we will need to manage carefully throughout this process, for example:
- the reputational and brand risks that could emerge if we don't handle the overall resolution process carefully;
 - the risk to NTP if concerns around how we treat sub-postmasters leads to lower take-up of the new models;
 - the opportunity cost arising from the significant amount of senior management time that will be taken up in handling this process;
 - the potential destabilising impact on the NFSP, who are feeling exposed to the whole issue because of accusations from some sup-postmasters that they failed to represent their interests; and
 - the process re-engineering that may be required for our IT, training and support systems will add further complexity and risk to the existing transformation programme.
29. These and other risks will be closely monitored and addressed through the weekly steering board.

Responses to other questions raised at the 23 July Board meeting

30. The Board requested further information on the insurance position: a separate note is attached on this. Annex A also provides further information Directors' duties as they relate to this review.
31. In response to the Board's request for a post-mortem, Internal Audit has now been tasked with carrying out a review of our response to the Second Sight investigation, reporting to the ARC. The terms of reference will be agreed with the Chair of ARC over the coming weeks.

LEGALLY PRIVILEGED AND CONFIDENTIAL

Next steps

32. We will provide a further update to the Board in late August, by which point we aim to have:
- i. finalised the terms of reference for the process of mediation and resolution in relation to the existing cases and also appointed the mediator, so we are ready to commence the process;
 - ii. agreed the process for filtering any 'new historical' cases that emerge;
 - iii. started engagement with key individual MPs on how we will be taking forward their cases;
 - iv. completed the second sift of past prosecuted cases;
 - v. developed an initial position on the pros and cons of continuing to bring prosecutions ourselves;
 - vi. identified 'quick wins' in relation to process improvements for sub-postmaster training and support, and started mapping the approach for longer-term improvements; and
 - vii. established the terms of reference for the Branch User Forum.

26 July 2013

LEGALLY PRIVILEGED AND CONFIDENTIAL

Annex A: Directors' duties

POL's directors are subject to various personal duties including the duties to:

- act in accordance with the company's constitution and for a proper purpose;
- promote the success of the company;
- exercise independent judgment;
- exercise reasonable care, skill and diligence.

Provided a director makes fair and reasoned decisions in good faith, s/he is unlikely to breach these duties.

If a director takes a decision in bad faith or maliciously, this could create personal liabilities, e.g. for:

- malicious prosecution against an SPMR;
- breach of the Data Protection Act in misusing personal / Horizon data;
- inducing a breach of contract between POL and an SPMR.

The duties are owed to the company, i.e. POL, and can only be enforced by POL. In rare circumstances, these duties can be enforced by a shareholder (i.e. BIS) acting on behalf of POL (a "derivative action"). These duties cannot be directly enforced by others, e.g. employees, contractors and/or SPMRs.

Directors should be careful when externally commenting on specific SPMRs / cases as they can be held personally liable for any defamatory comments.

There are no personal consequences for a director under criminal law if POL has failed to make adequate disclosure in any criminal proceedings as no director has directly and personally led the disclosure process.