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Return to Sender - Post Office Group Litigation Sheds Light on Good Faith and Onerous Terms in Relational Contracts

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Introduction

The recent case of *Bates v Post Office Ltd (No 3)* [2019] EWHC 606 (QB) 2019 involved a trial of a number of "common issues" as part of the group litigation by sub-postmasters against the Post Office based largely around the question of whether the former should be held liable for accounting shortfalls in post office branches which the sub-postmasters maintain were due to defects in the accounting software they were obliged to use. The judgment by Fraser J in the High Court sheds further light on the law relating to good faith in relational contracts and the incorporation of onerous and unusual terms.

Background

There were 589 claimants, who were mostly sub-postmasters responsible for running Post Office branches. The Post Office contracted with them on two standard forms and allowed no negotiation over their terms. The first form, the Sub Postmasters Contract ("SPMC"), used for contracts made before 2011, stated that the sub-postmaster was responsible for all losses caused through his or her negligence, carelessness or error, and also for losses caused by his or her assistants. In 2011, the Post Office then introduced the Network Transformation Contract ("NTC"). With one exception, this stated that the sub-postmaster should be fully liable for any loss, however that occurred and whether it occurred as a result of any negligence by the sub-postmaster, its personnel or otherwise.

The Post Office required the sub-postmasters to use an electronic point-of-sale and accounting system called Horizon. The claimants maintained that software defects in the system resulted in unexplained shortfalls and accounting discrepancies. Both contracts required the sub-postmaster to pay any shortfall in full. The Post Office maintained that individual sub-postmasters had to prove that the shortfalls were not their individual responsibility. Some claimants paid the shortfalls despite disputing them; some had their contracts terminated and others received criminal convictions. The Post Office later confessed that some of these prosecutions were wrong, which led to an investigation by the Criminal Cases Review Commission.

The claimants' case was that the Horizon system contained a large number of software coding errors, bugs and defects, and as a result of this threw up apparent shortfalls and discrepancies in the accounting of different branches. Alleged shortfalls in the claimants' financial accounting with the Post Office were said to have been caused by these problems with the way the Horizon system operated, the training that was provided to use it, and also a general failure of the Horizon helpline. These shortfalls and discrepancies, it was said by the claimants, all started once Horizon was being used from 2000. The sub-postmasters claimed damages for financial loss, personal injury, deceit, duress, unconscionable dealing, harassment and unjust enrichment. The Post Office denied that Horizon was defective and raised various contractual defences. A trial was held to resolve issues of contract interpretation, before breach, causation and loss were considered.

In a previous application (*Bates v Post Office Ltd (No.2)* [2018] EWHC 2698) the Post Office objected to vast tracts of the claimants' evidence of fact and sought to strike it out in advance of the trial. Fraser J dismissed this application, but the Post Office continued in the present hearing to insist that none of the evidence that the judge had refused to strike out was relevant to any of the common issues in dispute. He remarked:

> *"The Post Office seemed to adopt an extraordinarily narrow approach to relevance, generally along the lines that any evidence that is unfavourable to the Post Office is not relevant."*

There were 6 claimants called as witnesses in *Bates (No. 3)*. They had been selected by the parties as representative of the hundreds of claimants that were subject to the Group Litigation Order. These six were known as the 'lead claimants'. In addition, the Post Office called fourteen witnesses in support of their case. An examination of Fraser J's view of the witness evidence of one lead claimant and one Post Office witness is helpful to put his later findings on the law in context. It also shows the dangers of preparing evidence with the aim of portraying one party in the best light possible.

Mrs. Pamela Stubbs

One of the Lead Claimants, Mrs. Pamela Stubbs, became a sub-postmaster in August 2009, on the very day after her husband, the previous sub-postmaster at that particular branch, had died. Sometime later she discovered that the Horizon software had generated a shortfall of £9,000 over Christmas and New Year 2009, a period when her post office branch was closed. The Post Office subsequently told her to resign.

There was a dispute between the parties about the terms of the contract that she entered into with the Post Office, the day after her husband's death. The Post Office argued that she would have been sent a SPMC as well as other documents. They submitted that Mrs Stubbs *"understood she would be bound by (and very probably physically signed her agreement to be bound by) the terms of the SPMC"*, and *"very likely had a copy, and in any event had every opportunity to obtain a copy"*.

When Mrs. Stubbs gave evidence of a different version of events, counsel for the Post Office put to her that such "everyday events" would not be clear in her memory. The exchange went as follows:

> *"Q. The questions I am going to ask you about mainly today are events occurring in around 1999.*
> *A. Yes.*
> *Q. So some 19-odd years ago. It is fair to say your memory of the details of those events is probably pretty vague, is that fair?*
> *A. No, I don't think so.*
> *Q. In terms of -- these are everyday events. They're not -- in terms of receiving this document, that document. They are not particularly stunning events, are they, like a car crash or something of that kind that would particularly attach it to your memory, is that fair?*
> *A. If you are talking about August 1999 then, yes, they are very similar to a car crash."*

Unsurprisingly, Fraser J held that "*given the seismic nature of* [August 2009] *in terms of her life in general*" Mrs Stubbs had a clear recollection of the events of that month. The judge went further by dismissing the suggestion that Mrs Stubbs received the SPMC on the day after her husband died or should have obtained a copy:

> *"In my judgment these submissions by the Post Office are bold, pay no attention to the actual evidence, and seem to have their origin in a parallel world."*

Fraser J concluded his evaluation of Mrs Stubbs by describing her as a "careful and honest witness". The other Lead Claimants were similarly found to have given evidence honestly and to the best of their ability. This was in stark contrast to the witnesses called in support of the Post Office.

Mrs. Van Den Bogerd

The most senior witness for the Post Office was Mrs Van Den Bogerd. She started with the Post Office in 1985 and rose to become the Business Improvement Director shortly before the trial. Her witness statement was the most substantial of all the Post Office witnesses and she was cross-examined over three days of the trial.

In her witness statement Mrs Van Den Bogerd made no reference to several documents she had authored which highlighted problems with the Horizon system, and which contradicted the Post Office's case. When counsel for the claimants asked why this information was not referred to in her witness statement Mrs Van Den Bogerd answered that her witness statement was already very long and that she did not think the material was sufficiently relevant. Fraser J was not impressed by this approach to giving evidence, stating:

> *"In a witness statement by her of 145 paragraphs, 44 of those are devoted to the Post Office as a business. None at all deal with the very great number of detailed points put to her by [counsel for the claimants], based on internal Post Office documents over the years, which demonstrate an internal view of unsatisfactory performance at odds with the Post Office position in the case. This therefore must mean that Mrs Van Den Bogerd is an extremely poor judge of relevance. Her judgment also seems to have been uniquely exercised to paint the Post Office in the most favourable light possible, regardless of the facts."*

The judge held that Mrs Van Den Bogerd was a particularly stark example of a witness forcing their evidence of fact to fit with a pre-ordained thesis. For one thing, Fraser J remarked with some incredulity that Mrs Van Den Bogerd remained of the view that none of the different claims by the 589 claimants had common issues or themes between them, and every single case was simply factually different, with no connection between them. This was despite the approval of a Group Litigation Order by the President of the Queen's Bench Division.

On hearing evidence from Mrs Van Den Bogerd and other Post Office witnesses the learned judge questioned whether some of the Post Office's legal tactics were used because *"it fears objective scrutiny of its behaviour".* He highlighted what he described as *"a culture of secrecy and excessive confidentiality generally within the Post Office, but particularly focused on Horizon".* He concluded that the witnesses called by the Post Office were *"so entrenched that they appear absolutely convinced that there is simply nothing wrong with the Horizon system at all".* It was against this background that Fraser J considered the claimants' argument that there was an obligation of good faith between the Post Office and the sub-postmasters.

Good faith

In *Yam Seng Pte Ltd v International Trade Corp Ltd* [2013] EWHC 111 (QB) Mr Justice Leggatt advocated for a general implied term that in certain contracts parties should perform their obligations in good faith. Such a term is said to be implied in fact, i.e. it is based on a finding as to the objective intention of the parties in any contract, unlike terms implied in law which are implied on broader grounds of social policy into all contracts of a certain type, e.g. the implied term in an employment contract that the employer owes a duty of care to ensure the safety and well-being of the employee.

One of the factors taken into account to determine if a duty of good faith is implied is that the contract is of a particular type referred to as a 'relational contract'. This is often described as a long term contract which calls for collaboration and co-operation between the parties and a greater regard for each other's interests than ordinary commercial parties dealing with each other at arm's length. Examples of such contracts may include some (but not all) long term distribution contracts, joint ventures, and franchise agreements.

In the *Bates case*, Fraser J set out what he regarded as a non-exhaustive list of the characteristics which make up a relational contract, as follows:

> *"(a) no express terms preventing a duty of good faith being implied;*
> *(b) a long-term contract, with a mutual intention of a long-term relationship;*
> *(c) an intention for the parties' roles to be performed with integrity and fidelity to their bargain;*
> *(d) a commitment for the parties to collaborate in performing the contract;*
> *(e) the spirits and objectives of the venture being incapable of exhaustive expression in a written contract;*
> *(f) the parties reposing trust and confidence in one another, but of a different kind to that involved in fiduciary relationships;*
> *(g) a high degree of communication, co-operation and predictable performance based on mutual trust and confidence, and expectations of loyalty;*
> *(h) a degree of significant investment by one or both parties; and*
> *(i) exclusivity of the relationship."*

He also held that the following factors were not relevant to whether the contract was relational:

> *"(a) the imbalance of bargaining power between the parties;*
> *(b) the unfairness of some terms;*
> *(c) the bad behaviour of a party;*
> *(d) that a party was a company (as a few of the sub-postmasters were), not an individual;*
> *(e) that the contract was a commercial contract; and*
> *(f) the length and detail of the terms."*

The judge then considered these factors and concluded that the relationship between the Post Office and sub-postmasters was one that justified the implication of a general term that the parties should perform their obligations in good faith.

But what did 'good faith' mean in this context? Fraser J confirmed that it means more than just honesty but that it was difficult to lay down further general principled guidance. The furthest he was prepared to go was to say that good faith requires the parties not to behave in a way that "*would be regarded as commercially unacceptable by reasonable and honest people*". One can, however, get a sense of the type of obligations that an implied term of good faith may impose by considering two obligations which the judge held were present in the contracts between the Post Office and the sub-postmasters:

> *"(a) To communicate, alternatively, not to conceal known problems, bugs or errors in or generated by Horizon that might have financial (and other resulting) implications for the Claimants;*
>
> *(b) To communicate, alternatively, not to conceal the extent to which other Sub-postmasters were experiencing relating to Horizon and the generation of discrepancies and alleged shortfalls."*

Also notable was Fraser J's ruling that the general duty of good faith applied to the Post Office's exercise of certain rights of suspension, or termination. Previous decisions had said that the exercise of remedial rights like termination, or rescission do not involve the exercise of "discretion" which is subject to the good faith duty. The effect of this was that even clauses which purported expressly to give the Post Office the right to terminate for convenience by specifying a notice period of "not less than three [or six] months" had to be exercised in good faith. The judge drew this conclusion not only from the general duty of good faith, but also from the fact that the specified notice period was expressed as a minimum. This, he said, created a discretion and a duty to decide

what notice to give, which must not be decided arbitrarily or considering irrelevant factors. Relevant factors, he said, would include the reason for wanting to close the branch, whether the sub-postmaster lived in the business premises, how long they had been in the post and how much they had invested in the business. Irrelevant factors, the judge said, would include whether the sub-postmaster had joined in the group litigation or asked awkward questions about the Horizon software.

Onerous and unusual terms

The claimants also pleaded that a large number of the terms of their contracts with the Post Office fell into the category of onerous or unusual clauses. If a provision in a standard form contract is unusual and particularly onerous the party relying on it must show that the provision was fairly brought to the attention of the other party (*Interfoto Picture Library Ltd v Stiletto Visual Programmes Ltd* [1987] EWCA Civ 6). An 'onerous' term, for this purpose, is one with the potential to act very severely to the detriment of the party in question, almost to the point of being a punishment or adding an additional liability. The more severe the effect of the clause, the greater the notice required to incorporate it.

In *Bates*, Fraser J found that the following types of terms in the contracts between the Post Office and the sub-postmasters were both unusual and onerous:

- Unlimited liability without fault or control. The judge identified as unusual and onerous terms imposing unlimited liability on the sub-postmasters for all losses actually incurred, whatever the cause, even if it was entirely outside their control.

- Power to deny payment. The judge also identified unusual and "potentially financially ruinous" onerous terms allowing the Post Office to deny payment for a period of suspension, even after the sub-postmaster was reinstated, while requiring the suspended sub-postmaster to carry on the business and pay its costs throughout.

- Termination by notice with no minimum contract period. The contracts demanded considerable initial investment by the sub-postmaster and were intended to last for many years. If the Post Office's right to terminate by notice had not been subject to an implied duty of good faith, the judge would have found the right to terminate by 3 months' notice was unusual and onerous in allowing the Post Office to give notice of termination as soon as the contract was made, without a minimum initial period.

- No compensation for suspension or termination. The judge found that provisions denying the sub-postmasters' holiday, sick pay and pensions were not unusual or onerous. But provisions denying them any compensation for loss of office were unusual and onerous, even though the sub-postmasters were not employees.

- Instant termination for any breach. Obiter, the judge thought that a power of instant termination for even a minor breach would be unusual and onerous. In this case, he had found there was no such power in the contract, properly interpreted.

- One party's right to change contract terms. Obiter, Fraser J thought an unqualified right to change the substantive terms of the transaction without the other's consent might be so unusual and onerous as to need extra notice. On the terms of the contracts in question the judge found the right was qualified by an implied duty to exercise it only in good faith. But, even if there had been no duty of good faith, his

> decision in this case was that the right required no extra notice, although he thought that the amendments introduced by exercising the right might do so.

Since the contracts were made on the Post Office's written standard terms of business, the judge went on to apply the reasonableness test under section 3 of the Unfair Contract Terms Act 1977 ("UCTA"). Although an unusual and onerous term is not necessarily unreasonable, Mr Justice Fraser found that, in this case, the unusual and onerous terms largely failed the UCTA reasonableness test, making them unenforceable.

Conclusion

In the customarily frank manner in which Fraser J tends to conclude his judgment, he said:

> *"The Post Office describes itself on its own website as "the nation's most trusted brand". So far as these Claimants, and the subject matter of this Group Litigation, are concerned, this might be thought to be wholly wishful thinking. Trust is an element of an obligation of good faith, a concept which I find is to be implied into the contracts between the Post Office and the SPMs because they are relational contracts. The Post Office asserts that its brand is trusted by the nation, but the SPMs who are Claimants do not trust it very far, based on their individual and collective experience of Horizon."*

In fact the judge was generally so scathing about the conduct of the Post Office in his decision that the Post Office subsequently made an application to Fraser J himself asking that he recuse himself from the remainder of the group litigation for bias. That application failed, and Fraser J will now continue to conduct hearings on breach and causation for individual claimants. In any event, the Bates decision is a welcome illustration of the approach English courts take to the imposition of a general obligation of good faith into relational contracts under English law, and the types of terms that are likely to be onerous and unusual, and therefore probably unenforceable, in commercial relational contracts. However, the Post Office contracts are fairly unique, and it remains to be seen how easily some of the principles discussed by the court in *Bates* translate into similar findings in other situations.