Case Reporter

Josh Lewison of **Radcliffe Chambers** reports on a recent corporate insolvency case

Lehman Brothers Australia Ltd (in liquidation) v MacNamara & Ors (the joint administrators of Lehman Brothers International (Europe) (in administration)

[2020] EWCA Civ 321

The rule in *Ex parte James* (1873-74) LR 9 Ch App 609 has been brought back from the dead by the Court of Appeal, reversing a decision of Mr Justice Hildyard. Further consideration was also given to para 74 of Sch B1 to the Insolvency Act 1986. Both the rule and para 74 are intended to prevent an office holder from causing unfair harm to a given creditor:

- The rule in *Ex parte James* is that the court may prevent an office holder from insisting on their strict legal rights if such insistence would be unfair;
- Paragraph 74 allows the court to grant relief where an administrator is acting, has acted or is proposing to act in a way which unfairly harms the interests of the applicant.

Hildyard J had found that the correct expression of the rule in *Ex parte James* was whether what is proposed would be pronounced to be obviously unjust by all right-minded men and that the threshold test was unconscionability rather than unfairness. He held that the circumstances in which it would obviously be unjust to rely on a legal right conferred by contract would be few and far between and would normally be confined to cases where the general law provided no remedy. Where there was such a remedy, it is unlikely that there would be any separate jurisdiction for the court to interfere.

The judge held that para 74 had a different focus from the rule in *Ex parte James*, in that it was concerned with the exercise of the administrators' powers in the conduct of the administration, rather than in imposing moral constraints on contractual rights. The nature of the test was also different. The rule in *Ex parte James* was about unconscionability, while para 74 was concerned with differential or discriminatory treatment.

THE FACTS

Lehman Brothers Australia ('LBA') and Lehman Brothers International (Europe) ('LBIE') are both subject to insolvency proceedings. Each was part of the Lehman Brothers group and participated in substantial intra-group dealings. Through their respective office holders, LBA and LBIE had submitted proofs of debt in each other's insolvency proceedings.

In order to resolve those cross-claims, the liquidators of LBA and the administrators of LBIE entered into negotiations. Those culminated in the creation of a spreadsheet ('the Model') by LBIE's administrators, containing the suggested valuation of the various cross-claims and conversion from foreign currencies to Sterling. The Model showed that LBA had claims totalling nearly £29m and LBIE had claims totalling £5.5m, so that LBA had a total net claim for £23.3m in LBIE's administration.

The parties implemented their settlement through documents known as Claims Determination Deeds ('CDDs'). CDDs had been used extensively in the course of the LBIE administration. There were two advantages to CDDs. The first was that it conveniently fixed the level of claim made by a creditor, so as to provide certainty in the administration. The second was that the benefit of a CDD could be assigned, so that a secondary market in Lehman debt has now become active.

The parties, with the assistance of their lawyers, negotiated two CDDs. The important one was the LBA CDD, which compromised the net claim for £23.3m.

The Model, though, contained an error. One of the bonds underlying LBA's claim was a bond issued by an Australian bank. It was recorded in the Model as having a value of AUD 4.8m. In fact, the bond was denominated in Euro, so that it should have been recorded with a value of €4.8m. If that had been done correctly, the currency conversion and netting process would have resulted in a net claim in favour of LBA of £25m. Thus, the error cost LBA about £1.6m.

By the time the error was discovered, LBA had accepted payment in full of the amount recorded in the LBA CDD. On discovery, LBA sought to agree an amendment to the CDD. LBIE refused, on the basis that the whole point of entering into a CDD was to provide finality, rather than exposing the administrators to the possibility of fluctuating claims.

It was not in dispute that there was a mistake in the LBA CDD, so that the underlying claim had been compromised for less than its true value. It was also not in dispute that the LBA CDD was contractually binding in all respects. LBA expressly asked the judge at first-instance to assume that rectification was not available.

Biog box
Josh Lewison is a barrister at Radcliffe Chambers. He specialises in insolvency and contentious trusts. He has extensive trial experience as well as applications for interim relief including freezing orders and other injunctions. Most of Josh's work is domestic, but he has substantial offshore experience, principally in the Channel Islands. He also has experience of cross-border insolvency. Email: jlewison@radcliffechambers.com

THE ISSUES ON THE APPEAL

Lord Justice David Richards gave the only judgment in the Court of Appeal. He identified three issues on the appeal:

- The first was the threshold test for the application of the rule in *Ex parte James*: was it unconscionability or was it unfairness?
- The second was the proper approach to a claim under para 74;
- The third was whether it was right that neither the rule in *Ex parte James* nor para 74 could prevent the enforcement of contractual terms.

THE RULE IN *EX PARTE JAMES*

David Richards LJ anchored his reasoning in the general principle underlying the rule in *Ex parte James*. The general principle is that given the court's position in society, the court is expected to apply standards to its own conduct that go beyond bare legal rights and duties. Insolvency practitioners (IPs), acting in the course of their appointments, are officers of the court. They are therefore acting on behalf of the court and should abide by the same standards of conduct.

The judge was at pains to point out that the standard is applied on an objective basis. A challenge based on the rule in *Ex parte James* is not concerned with the personal integrity of the individual IP whose conduct is challenged. Rather, the question is whether the conduct falls below the standard set by the court. The distinction is, perhaps, an elusive one. In any given case, the IP will have decided on a particular course of action. It is implicit in any challenge that if the proposed conduct falls below the standard set by the court, then the IP must have chosen to act in that way. It is therefore a question of personal judgment on the part of the IP.

David Richards LJ then analysed the line of cases starting with *Ex parte James* itself. The focus was on the language used in the various judgments over the years to articulate the test. The judge noted at the outset that numerous terms had been used, which was partly because the standard had not been laid down in statute and partly because the standards expected by society had evolved. The key cases considered were:

- *Ex parte James*. In that case, a trustee in bankruptcy was proposing to retain money paid under a mistake of law, which at that time was not recoverable in restitution. The Court of Appeal held that the bankruptcy court 'ought to be as honest as other people.'
- *Ex parte Simmonds* (1885) 16 QBD 308. Again, the trustee was proposing to retain money paid under a mistake of law. Lord Esher MR held that the court: 'will direct its officer to do that which any high-minded man would do, viz., not to take advantage of the mistake of law'.
- *In re Tyler, ex parte Official Receiver* [1907] 1 KB 865. A trustee was proposing to retain surplus money from the proceeds of an insurance policy on the life of the bankrupt where the bankrupt's wife had paid the premiums. The court spoke of an officer of the court being 'even more straightforward and honest than an ordinary person in the affairs of every-day life' and of the 'fair, straightforward, honest, open dealing which ought to characterise transactions between vendor and purchaser'.
- *In re Thellusson* [1919] 2 KB 735. The Court of Appeal referred to 'a line of conduct which an honest man actuated by motives of morality and justice would pursue, although not compellable thereto by legal process' and to 'real and substantial dishonesty or unfairness or injustice'.
- *In re Wigzell* [1921] 2 KB 835. The Master of the Rolls used 'unfair', 'dishonourable' and 'unconscionable' interchangeably.
- *In re Clark (a Bankrupt)* [1972] 1 WLR 559. Walton J held: 'where it would be unfair for a trustee to take full advantage of his legal rights as such, the court will order him not to do so, and, indeed, will order him to return money which he may have collected.'
- *Re Nortel GmbH (in administration)* [2014] AC 209. Lord Neuberger expressed the test as based on unfairness.

The survey of the cases led David Richards LJ to the conclusion that unfairness had been articulated as part of the test from an early stage in the development of the law. In addition, there had been only slender authority to support a test of unconscionability. His conclusion was: '. The court will not permit its officers to act in a way that it would be clearly wrong for the court itself to act. That is to be judged by the standard of the right-thinking person, representing the current view of society. If one were to pose the question 'would it be proper for the court to act unfairly?', only one answer is possible.'

PARAGRAPH 74 OF SCH B1

Turning next to para 74, David Richards LJ adopted an expansive view of its scope. He held that where an administrator is acting in accordance with his or her *obligations*, there is no question of causing *unfair* harm. However, where an administrator is exercising their *discretion*, the court could grant relief in an appropriate case.

The judge noted that para 74 is drafted widely and adopts the objective standard of fairness. While it would be an important consideration that an administrator was acting in the interests of creditors as a whole, that did not preclude an individual creditor from relying on the paragraph if they had suffered unfair harm.

APPLICATION TO CONTRACTUAL TERMS

David Richards LJ went on to criticise the decision of Hildyard J that neither the rule in *Ex parte James* nor para 74 could prevent an administrator from relying on contractual rights, freely bargained for. The authorities did not support any such principle. While it would be a relevant factor that the parties had contracted, it would not be an absolute bar to relief.

CONCLUSIONS

Under the first instance decision, the rule in *Ex parte James* appeared to have reached the point at which it might never be successfully invoked. The Court of Appeal has breathed new life into the rule. The point, however, still stands that the modern law, and in particular the law of restitution, rectification and interpretation, has developed significantly since the heyday of the rule. That means that remedies are more likely to be available where things go wrong and, in turn, there will still only be little scope for the application of the rule in *Ex parte James*. ■