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Lehman Brothers Australia Limited (in liquidation) v Anthony Victor Lomas, Steven Anthony Pearson, Russell Downs, Julian Guy Parr (The Joint Administrators of Lehman Brothers International (Europe) (in administration)) [2018] EWHC 2783 (Ch), 24 October 2018, Hildyard J

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Synopsis

In this case Hildyard J held that neither the rule in *Ex Parte James* (1873-74) LR 9 Ch App 609 nor paragraph 74 of Schedule B1 of the Insolvency Act 1986 justified the Court interfering in a contract which had been freely entered into by the parties. This was so even where both parties agreed that there had been a mistake in the calculation of the sum owed by the respondent, Lehman Brothers International (Europe), to the applicant, Lehman Brothers Australia. The jurisdiction conferred by the rule in *Ex Parte James* was limited to circumstances in which it would be unconscionable for officeholders to uphold their legal rights, and relief under paragraph 74 of Schedule B1 was restricted to situations in which officeholders proposed to act in a discriminatory manner between creditors. Since neither applied in the instant case, the application was dismissed.

Introduction

This application concerned the scope of the Court's discretion to direct its officeholders under the rule in *Ex Parte James* (1873-74) LR 9 Ch App 609 and/or paragraph 74 of Schedule B1 to the Insolvency Act 1986. The question was whether the administrators of Lehman Brothers International (Europe) ('LBIE') should be directed to admit a claim from Lehman Brothers Australia ('LBA') in an amount greater than the amount contractually agreed between the parties. The parties had entered into a contract which, on its face, finally determined certain claims between them. Over two years later, it emerged that the sum arrived at had been miscalculated due to an innocent mistake overlooked by both parties. LBIE submitted that the amount stated in the contract was conclusive as to the amount that it owed. LBA accepted that the contract was binding, but submitted that the Court should direct LBIE not to rely on its contractual rights therein. Hildyard J declined to make any direction under either *Ex Parte James* or paragraph 74, holding that, in the circumstances, neither enabled the Court to interfere in the contractually binding arrangements. He discussed the previous authorities for both rules in some detail, and, in doing so, sought to clarify the scope of each. In his view 'neither paragraph 74 nor the rule in Ex Parte James should be treated as a magic wand, and that outside the context of obviously unjust reliance on defects or gaps in the law and/or the abuse or perverse use of power both must be deployed with caution, insofar as available at all' ([81]).

Background

In order to assist with the efficient administration of LBIE's estate, its administrators entered into numerous bilateral contracts, which determined the size of the claim which that creditor was entitled to make against LBIE. These were called 'Claims Determination Deeds' and their purpose was to provide finality and certainty for LBIE and its creditors. Over 2,300 such contracts were agreed by the administrators.

The Claims Determination Deed between LBA and LBIE was dated 12 March 2014 and provided that, in respect of the claims covered by the agreement, LBA was entitled to claim £23,533,508 from LBIE's estate. This amount was paid in full on 30 April 2014. Several years later, following investigations by a prospective purchaser of LBIE's residual claims against LBA, it emerged that the Claims Determination Deed had contained a calculation error. The value of a bond owed to LBA by LBIE was erroneously recorded as being in Australian Dollars rather than in Euros. But for the error, LBA would have been entitled to claim £25,028,091. Both parties acknowledged that this was an innocent mistake.

The question in this application was whether the administrators of LBIE should be directed to admit a claim

by LBA in the amount that it would have been entitled to if the mistake has not been made.

The rule in *Ex Parte James*

The rule in *Ex Parte James* enables the Court to direct an officer of the court not to rely on his strict legal rights in circumstances where doing so would be unequitable and cause the insolvent estate to be unjustly enriched. The central tension in the case law considered by Hildyard J was whether the touchstone for the Court's jurisdiction under *Ex Parte James* is unfairness to the creditor, or whether it is necessary that the officeholder's reliance on strict legal rights would be dishonourable. Adopting the same approach as in his recent judgment in *Heis v Financial Services Compensation Scheme Limited* [2018] EWHC 1372 (Ch),[1] Hildyard J held that the touchstone was dishonourable behaviour by the officeholder. In particular, he considered the Court of Appeal's decision in *Re Wigzell* [1921] 2 K.B. 835 to be binding, and therefore held that (at [61]):

> 'the discretionary jurisdiction which the rule expresses to prevent the enforcement of legal right when it would be contrary to 'natural justice' was not to be used (in the words of Salter J in *Re Wigzell*) "unless the result of enforcing the law is such that, in the opinion of the Court, it would be pronounced to be obviously unjust by all right-minded men."
>
> In other words, in the context the phrase 'contrary to natural justice' connotes more than subjective unfairness: it connotes that what is proposed would be such that undoubtedly a "high-minded" and "honourable" man (per Lord Sterndale MR and Scrutton LJ in *Re Wigzell* at pages 851 and 862 respectively) would not do it because it would be "dishonourable and not high-minded" (ibid.)'

In rejecting the unfairness test, Hildyard J departed from the view expressed by David Richards J in *Re LBIE (Waterfall IIB)* [2015] BPIR 1162. Although, as a result of his other findings, reliance on *Ex Parte James* was not necessary in that case, David Richards J discussed the scope of the rule *obiter dicta.* He relied particularly on *Re Clark* [1975] 1 WLR 559, where Walton J described the rule as operating where it would be 'unfair for a trustee to take full advantage of his legal rights' (p563). Commenting on *Re Clark*, David Richards J said (at [180]):

> 'It might be said that Walton J used the word "unfair" as synonymous with dishonourable or even dishonest, but I very much doubt it. Walton J was not a judge known for a lack of precision in his use of language and his repeated use of the word unfair in his judgment demonstrates in my view the concept which he had in mind.'

As a result, David Richards J concluded that if it had been necessary to rely on the rule in *Ex Parte James,* he would have directed the officeholders not to enforce certain contracts on the basis that the alternative would have been unfair to the relevant creditors.

Hildyard J had no hesitation departing from David Richard J's comments in Waterfall IIB, firstly because he considered them to be in the nature of *obiter dicta* and therefore not binding, and secondly because he considered that both Walton J in *Re Clark* and David Richards J had failed to follow the binding judgement of the Court of Appeal's in *Re Wigzell.* Rather than enabling the Court to interfere in consensual arrangements that could be subsequently characterised as unfair to one party, Hildyard J emphasised that the jurisdiction of the Court under the rule in *Ex Parte James* turned on the behaviour of officeholders. In other words, the rule should operate so as to enable the Court to prevent the officeholder from being forced to choose between enforcing his legal rights and thereby securing an unfair advantage to the estate, and acting honourably with respect to one creditor, but arguably falling short of his duty to the rest ([58]).

Hildyard J concluded that in the present case he did not have jurisdiction under the rule in *Ex Parte James.* Whilst enforcing the contractual arrangement might be subjectively regarded as unfair, it did not constitute dishonourable behaviour by the officeholder. Hildyard J went on to hold that, even if he had found jurisdiction under the rule, he would have declined to exercise it on the basis that the agreement between LBA and LBIE was binding and enforceable, and its terms were designed to provide finality between the parties.

Paragraph 74 of Schedule B1

Paragraph 74 of Schedule B1 enables the Court to grant relief where:

> '(a) the administrator is acting or has acted so as unfairly to harm the interests of the applicant (whether alone or in common with some or all other members or creditors), or
>
> (b) the administrator proposes to act in a way which would unfairly harm the interests of the applicant (whether alone or in common with some or all other members or creditors).'

In this case, LBA relied on subparagraph (b), claiming that it would be unfair for LBIE to enforce the terms of

Notes

1 Although Hildyard J's conclusions on construction in that judgment were overturned by the Court of Appeal ([2018] B.P.I.R. 1142) his conclusions on *Ex Parte James* and paragraph 74 of Schedule B1 were not challenged.

the Claims Determination Deed given that the mistake had emerged.

As with the rule in *Ex Parte James,* paragraph 74 is 'capable of subjecting the exercise of legal right to an ultimately subjective standard' (*Heis* at [143], cited at [58]). However, whereas *Ex Parte James* operates to prevent an officeholder from being bound to act dishonourably in promulgating the unjust enrichment of the insolvent estate, paragraph 74 enables a creditor to seek protection from discriminatory behaviour of the officeholder.

In considering the meaning of 'unfair harm', Hildyard J cited *Re Lehman Brothers International (Europe) (in administration, Four Private Investment Funds v Lomas)* [2009] BCC 632. He emphasised that in this context, 'unfair harm' meant an exercise of powers by the officeholder which '(a) causes or would cause disadvantage to that creditor; (b) cannot be justified by reference to the interests of the creditors as a whole or to achieving the objective of the relevant insolvency process; and/or which (c) is discriminatory in such effect' ([78]). In the instant case, there was no unfair harm caused to LBA: the contract was part of a number of contracts designed to give finality to creditors, it had been freely entered into between the parties, and the mistake was an innocent one. It was not 'discriminatory' for the administrators of LBIE to enforce their rights under the agreement, and LBA would not, therefore, suffer any unfair harm.

Conclusion

In general terms, Hildyard J's judgment seeks to confine the rule in *Ex Parte James* and paragraph 74 to circumstances where the behaviour of the officeholder is or is threatened to be dishonourable and discriminatory respectively.

More particularly, it is clear that Hildyard J did not feel it would be appropriate for the Court to direct its officeholders not to enforce contractual arrangements in circumstances where, absent an insolvency process, there would have been no remedy for LBA. In this context, it was relevant that LBA had not sought to argue that the contract should be rectified on the ground of common mistake, and indeed appeared to concede that that remedy was not available to them. In Hildyard J's view there is a bright line between the Court exercising its direction to control the behaviour of an officeholder in his capacity as such, and interfering in consensual contractual arrangements reached between the company and an individual creditor.

In both this judgment and his previous decision in *Heis,* Hildyard J sought to discourage reliance *Ex Parte James* and paragraph 74 in circumstances one party is, with hindsight, dissatisfied with an agreement reached. Whilst this is a sensible limitation, it is possible that parties may continue to test the scope of both rules, at least until the matter falls for consideration by the Court of Appeal.

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