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REVISITING *EX PARTE JAMES*

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There has been much judicial and academic debate over the proper scope of and rationale underlying the principle in *ex parte James*, and in particular its conferral of *de facto* insolvency priority on the successful claimant. This article attempts to review the principle's operation in the context of the function and principles of insolvency law, determine the actual role that it plays in dealing with post-insolvency claims and accordingly identify the justifications that can be offered for this role. It argues that the principle is better seen as an application of the liquidation expenses principle or the fair treatment of certain post-insolvency claims.

I. INTRODUCTION

Despite an initially frosty reception in the Singapore High Court,[1] the principle in *Re Condon, ex parte James*[2] ("*ex parte James*") has been endorsed in two recent cases. In *Re PCChip Computer Manufacturer (S.) Pte. Ltd.*,[3] the High Court reaffirmed the jurisdiction of our courts under *ex parte James* to require a liquidator, in his capacity as a court officer, to refund in full a mistaken overpayment made by a bank to the liquidator during a compulsory winding up. In *Re Pinkroccade Educational Services Pte. Ltd.*,[4] the same judge declined to apply the rule on the ground that it does not extend beyond court appointed officers in charge of insolvency proceedings to regulate a private liquidator of a voluntary winding up.

While the existence of the principle is clearly established, the attitude of the courts towards its invocation has been varied. On the one hand, it has been criticised for its vague prescriptions and the apparent arbitrariness in defining its sphere of application. Some judges have therefore called for a cautious and restrictive approach in applying *ex parte James*.[5] On

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1 *Re Drysdale* [1949] 1 M.L.J. 273.

2 (1874) 9 Ch. App. 609.

3 [2001] 3 S.L.R. 296.

4 [2002] 4 S.L.R. 867.

5 For example, *supra* note 1 at 277; *Re T.H. Knitwear (Wholesale) Ltd.* [1988] Ch. 275 at 289, *per* Slade L.J.

the other, the courts have implicitly welcomed the flexibility that the rule offers, particularly in dealing with problems concerning the treatment of post-insolvency[6] claims that arise during the course of administering insolvent estates, in the absence of clear statutory rules or guidelines. Creditors with claims against the insolvent individual or company that seek to rely on *ex parte James* do so with their eye on the main benefit of invoking the principle: achieving *de facto* priority in payment of their claim ahead of other unsecured creditors. This article attempts to review the principle's operation in the context of the function and principles of insolvency law, determine the actual role that it plays in dealing with post-insolvency claims and accordingly identify the justifications that can be offered for this role.

II. Contours of the Principle

Generally stated, the principle in *ex parte James* requires that a court appointed officer[7] administering an insolvent estate ("the officer") not insist on the strict legal rights of the estate where this would result in an enrichment to the estate contrary to the dictates of an extra-legal standard of "right-mindedness", "honesty", "fairness" or "natural justice". In *ex parte James*, the trustee in bankruptcy made an unlawful demand for the return of the proceeds received from execution after the bankruptcy had commenced. The execution creditor complied with this demand but the court required the trustee to refund the amount mistakenly paid over:

> I am of opinion that a trustee in bankruptcy is an officer of the Court. He has inquisitorial powers given him by the Court, and the Court regards him as its officer, and he is to hold money in his hands upon trust for its equitable distribution among the creditors. The Court, then, finding that he has in his hands money *which in equity belongs to someone else*, ought to set an example to the world by paying it to the person really entitled to it. In my opinion the Court of Bankruptcy *ought to be as honest as other people*.[8]

The reasoning of James L.J. is not entirely clear. The principle could have represented recognition by the bankruptcy court of a proprietary right or remedy of the claimant in the mistaken payment made to the trustee. If

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6 In this article, the terms "pre-insolvency" and "post-insolvency" are used to refer respectively to the periods *before* and *after* the relevant cut-off date on which claims against a bankrupt or company in winding up are provable.

7 For example, a trustee in bankruptcy appointed under s. 33 *Bankruptcy Act* (Cap. 20, 2000 Rev. Ed. Sing.) ("BA") or a liquidator in a compulsory winding up: s. 263 *Companies Act* (Cap. 50, 1994 Rev. Ed. Sing.) ("CA"). The rule does not apply to private liquidators: see *infra* note 121.

8 *Supra* note 2 at 614, *per* James L.J. [emphasis added].

so, this proprietary interest or remedy would have obliged the trustee in bankruptcy to treat the claim for repayment separate from the claims of all other unsecured creditors in the bankruptcy.[9] Or it could have been an infelicitous expression of a moral duty on the part of the officer, consistent with James L.J.'s use of the notion of "honesty", to repay the execution sum unlawfully demanded even though there was no legally enforceable right to recovery.[10] The courts thereafter moved along the latter course. In *Re Tyler*,[11] for example, Vaughan Williams L.J. held:

> When James L.J. says that the trustee has in his hands money which in equity belongs to somebody else, he is not referring to an equity which is capable of forensic enforcement in a suit or action, but he is referring to a moral principle which he describes when he says that the Court of Bankruptcy ought to be as honest as other people …[12]

The most structured analysis of the contours of the rule was provided in the case of *Re Clark,*[13] where Walton J. ruled that four conditions generally had to be satisfied in order for the principle to operate, namely:

(1) there must be an enrichment (at the expense of the claimant[14]);
(2) the claim must not be provable in the insolvency proceedings;
(3) it must be unjust or unfair for the court officer to retain the monies in question; and
(4) the rule operates only to the extent necessary to nullify the enrichment.

In respect of the first condition, the insolvent estate is in most cases enriched by a mistaken payment made to the insolvent estate or the officer personally after the commencement of the relevant insolvency proceeding. Courts have, however, taken a broad view of this requirement. Enrichments may take other forms, including mistaken payments of a bankrupt's debt to

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9 Proprietary claims stand aloof from insolvency proceedings. What is being enforced is the claimant's own property rights, not the insolvent individual's or company's: *Re David Lloyd Ltd.* (1877) 6 Ch. D. 339 at 344–345.

10 With the exception of *ex parte James*, where the underlying claim for recovery of a mistake of law payment was at the time not recoverable, the assumption is made in this article that the underlying claim would be, but for the rules of proof of debt in insolvency law, enforceable against the insolvent debtor. In this respect, *ex parte James* can be rationalized within the analysis that follows as a forerunner of the eventual abrogation of the bar against mistake of law claims: See *infra* note 31.

11 [1907] 1 K.B. 865, following *Re Carnac ex parte Simmonds* (1885–86) L.R. 16 Q.B.D. 308.

12 *Ibid.* at 869.

13 [1975] 1 All E.R. 453; applied in *Re PCChip Computer, supra* note 3.

14 *Re Treacy et al.* [1997] 32 O.R. (3d) 717 at 729.

third parties[15] or the continued supply of goods to a bankrupt in ignorance of the making of a receiving order.[16]

The second condition is not without exception,[17] but the courts have generally insisted that the claim in question not be provable against the insolvent estate.[18] Non-provability may result exceptionally from the claim not being legally enforceable at general law. It is, however, most often the case that the claim is not provable as the cause of action accrued after the statutory cut-off date for the provability of debts.[19] This requirement appears to be based on the mandatory *pari passu* principle of distribution. To allow otherwise would "confer a preference on an otherwise unsecured creditor" entitled to prove in the relevant insolvency proceeding.[20]

If honesty or fairness so require under condition (3), the principle has successfully been invoked most often to require the officer to refund, *in full* to the claimant, sums representing the enrichment that the court deems is improper in the circumstances for him to retain on behalf of the insolvent estate. However, *ex parte James* also operates even if there is no issue of retaining money improperly. For example, in *Re Associated Dominions Assurance Society Pty. Ltd.*,[21] the rule obliged a liquidator to waive a procedural limitation over a claim for payments in lieu of long service leave entitlements for employees of the insolvent company. Alternatively, the court may restrain the officer from recovering debts due from the claimant who has enriched the estate, in order to nullify the enrichment.[22]

However, the difficulty with the principle in *ex parte James* is determining when the requirements of honesty and fairness operate to restrain the officer from otherwise freely dealing with the property of the insolvent estate. The inquiry is not simply to determine if an equitable interest resides in the monies in question, for honesty and fairness extend beyond this, but one of ethical propriety.[23] However, the cases have acknowledged that honesty in the Jamesian sense is imprecise, and such questions are "the subject of honest difference among honest men".[24] At best, in establishing what is ethical, instances of what have been held to amount to dishonourable conduct may

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15 *Re Tyler, supra* note 11.

16 *Re Clark, supra* note 13.

17 See *Re Regent Finance and Guarantee Corporation Ltd.* [1930] W.N. 84.

18 See also *Re Hall* [1907] 1 K.B. 875; *Re Sandiford (No. 2)* [1935] Ch. 681; *Re Gozzett, ex. p. Messenger & Co. Ltd.* [1936] 1 All E.R. 79.

19 For example, *Re PCChip Computer, supra* note 3 at para. 38; *cf. Re Pinkroccade, supra* note 4 at para. 7.

20 *Re Clark, supra* note 13 at 458, *per* Walton J.; *Re Gozzett, supra* note 18.

21 (1962) 109 C.L.R. 516 at para. 5.

22 *Re Clark, supra* note 13.

23 *Re Tyler, supra* note 11, *Re South West Car Sales Ltd.* [1998] B.C.C. 163; *R. v. Tower Hamlets London Borough Council, ex. P. Chetnik Developments Ltd.* [1988] A.C. 858.

24 *Re Wigzell, ex. p. Hart* [1921] 2 K.B. 835 at 845, *per* Salter J.

have to be cited: A trustee seeking to enlarge the assets of insolvent estate by money that the estate was not strictly entitled to but could not be recovered in consequence of some technical rule of judge made law,[25] or seeking to enlarge the assets by retaining an asset without making reimbursement for a claimant's payments that went towards preserving the asset,[26] or simply retaining money which in the circumstances under which the loan was granted would be dishonourable for the bankrupt himself to have retained vis-à-vis the claimant.[27] In stark contrast to the last example, where a statute expressly confers a cause of action which forms part of the assets of the insolvent estate, there is nothing dishonourable in the officer enforcing the debt. He may discharge his duty to collect the asset and distribute it amongst the creditors beneficially interested in the estate, even though it would have been dishonourable for the bankrupt himself to have brought the action.[28] Notwithstanding these inherent vagaries and apparent inconsistencies, the court should not be deterred from maintaining high standards of commercial morality in the administration of insolvent estates.[29]

It is unclear what the basis for such a jurisdiction exactly is. The rule had its origins in a sidestep[30] of the now abrogated bar to recovering payments made under a mistake of law.[31] However, the *ex parte James* line of cases has since moved well beyond mistaken payments to regulate various types of dealings with an insolvent estate. The courts have also not insisted that a claimant demonstrate some proprietary interest or remedy in the assets of the insolvent estate. This detracts from the notion that general law proprietary interests or remedies under gird the rule.[32] Given the width of its ambit, current thinking places the *ex parte James* principle under the rubric of the general jurisdiction of the court over the conduct of its officers in administering insolvent estates.[33] On this basis and in view of the general conditions of its operation, it is submitted that *ex parte James* is concerned at its core with the treatment of post-insolvency claims by those officers.[34]

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25 *Ex parte James, supra* note 2.

26 *Re Tyler, supra* note 11.

27 *Re Thellusson, ex parte Abdy* [1919] 2 K.B. 735.

28 *Scranton's Trustee v. Pearse* [1922] 2 Ch. 87, C.A., at 119–125; *Re Wigzell, supra* note 24, is probably another instance where it was not dishonourable or unjust for the officer to enforce the statutory rights of the insolvent estate against the claimant.

29 *Re Thellusson, supra* note 27, *per* Atkin L.J. at 764.

30 *Star v. Silvia* 1994 N.S.W. LEXIS 13084 at 10.

31 *Kleinwort Benson Ltd. v. Lincoln City Council* [1998] 4 All E.R. 513; *Management Corporation Strata Title No. 473 v. De Beers Jewellery Pte. Ltd.* [2001] 4 S.L.R. 90.

32 *Hartogen Energy Ltd. (In Liq.) v. Australia Gas and Light Company* (1992) 109 A.L.R. 177 at 192.

33 *Ibid* at 192.

34 *Re Sandiford (No. 2), supra* note 18 at 691–92; see also Goff and Jones, *The Law of Restitution*, 6th ed. (London: Sweet & Maxwell, 2002) at 226, para. 5-016.

III. *Ex Parte James* and the Priority of Claims

To appreciate the impact that *ex parte James* has in insolvency proceedings, it is first necessary to outline the treatment of claims against an insolvent. Insolvency proceedings provide creditors of an insolvent individual or company with a collective means of debt collection.[35] This collective action confers on them various strategic and cost advantages over their pursuit of individual remedies under general, non-insolvency law.[36] In *Re National Building & Land Investment Co., ex parte Clitheroe*,[37] Chatterton V.C. explained that in dealing with creditors' claims against the insolvent estate, a broad distinction is drawn between pre- and post-insolvency creditors:

> The action was brought after the commencement of the winding-up, since which time all the [litigation] costs now claimed were incurred. … I consider the law to be now settled that they are payable and not provable. The distinction to be observed is one between debts and liabilities of the Company existing at the commencement of the winding-up, which must be proved for and paid *pari passu*, and must abate rateably in case the assets of the Company prove insufficient, and debts and liabilities which arise only in the course of the liquidation and as incidental to it, which must be paid before any distribution of assets.[38]

The chronological line dividing the two categories of claims is prescribed by the statutory rules of proof in the relevant proceeding. Thus, for example, s. 87 of the *Bankruptcy Act* ("BA") admits proof of debts that a bankrupt was subject to at the date of the bankruptcy order.[39] As *ex parte Clitheroe* notes, provable pre-insolvency claims are generally paid rateably in accordance with the *pari passu* principle of distribution. However, even then, some unsecured or preferential debts are paid in priority to others in accordance with a clear statutory order of priorities.[40] This prescribed order permits deviations from *pari passu* distribution, based presumably on a determination of the relative importance of the claims in question in accordance with the prevailing public policy of the jurisdiction in question.[41] Secondly,

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35 *Wight v. Eckhardt* [2003] 3 W.L.R. 414, para. 27.

36 Jackson, *The Logic and Limits of Bankruptcy Law* (Cambridge, Mass.: Harvard University Press, 1986), Chap. 1.

37 (1885) 15 L.R. Ir. 47.

38 *Ibid.* at 47.

39 When imported by s. 327(2) into the winding up regime under Part X of the CA, this corresponds with the date of the winding up order: *Re PCChip Computer, supra* note 3 at para. 38.

40 See s. 328 CA.

41 For example, employees claims for unpaid wages *etc.* are conferred priority over other unsecured creditors: s. 328(1)(b) CA. Preferential status is usually a function of the balance between the desire to preserve pre-insolvency contractual bargaining over priorities and the

claims accruing after the bankruptcy or winding up order that constitute bankruptcy or liquidation expenses are not proved but payable in priority ahead of all other preferential and unsecured creditors.[42]

In the majority cases where *ex parte James* was successfully invoked,[43] the rule has two very important consequences for a creditor whose claim is not provable and cannot establish a proprietary claim to set him apart from the relevant insolvency proceeding. Where the dictates of "honourable" dealing operate, the relevant court officer has been obliged by the court to refund in full the amount of the benefit to the claimant without the claimant in question having to compete with other pre and post-insolvency claims against the insolvent estate.[44] Consequently, a claim not otherwise provable is recognised for the purposes of distribution.

More importantly, in so far as the court requires the enrichment to be restored in *full*, or otherwise seeks to nullify it, the claimant acquires *de facto* insolvency priority over all other preferential and unsecured creditors to the extent that his recovery exceeds his *pro rata* dividend. Were the claim admitted to proof, it would only have received its rateable share in the assets of the insolvent estate after the payment of preferential creditors. The second condition in *Re Clark* implicitly recognises this effect by generally excluding provable claims. In so far as courts applying the *ex parte James* principle are prepared to countenance provable pre-insolvency claims,[45] they would in fact confer "super-preferential" status on claims that were otherwise unsecured and non-preferential. In so far as they have dealt with and altered the treatment of post-insolvency claims, they similarly confer insolvency priority—even potentially elevating those claims beyond the status of liquidation expenses.[46] Why should such priority be given to claimants invoking *ex parte James*? This admits of no easy answer, but it is suggested that three strains of justification appear from the cases and these will be evaluated in turn.

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desire to protect the interests of parties that are considered less able to protect their own interests, or the overriding public interest: see A. Keay and P. Walton, "The Preferential Debts Regime in Liquidation Law: In the Public Interest?" [1999] C.F.I.L.R. 84.

42 See ss. 90(1)(a) BA and 328(1)(a) CA respectively and discussion below.

43 *Cf. Re Associated Dominions Assurance Society Pty. Ltd., supra* note 21.

44 Or to decline to seek full recovery of monies paid out of the estate in preference to other unsecured creditors.

45 In *Re Pinkroccade, supra* note 4 at para. 8, Lee J. emphasised that the conditions prescribed by *Re Clark* are "not rigid rules of law because the principle in *Ex. P. James* is a statement of general policy … the failure to meet one or more conditions does not by itself determine the matter."

46 Section 328(1)(3) CA ranks preferential creditors within the same class *pari passu inter se*. Thus in the situation where there are insufficient assets to discharge liquidation expenses, the treatment that *ex parte James* affords the claimant would potentially also exempt him from sharing with the same class.

IV. Court Officers and Ethical Propriety

If we take the cases at face value, the source of *de facto* insolvency priority is the moral obligation of the officer to recognise claims that affect his conscience in dealing with the property of the insolvent estate.[47] But why should the unsecured creditors in general, who are the constituents of the insolvent estate, also be subject to the dictates of commercial morality? If the claims were in fact secured or proprietary in nature, they have no complaint. Apart from this, creditors presumably contracted with the individual or company on the basis that all unsecured claims would rank equally in an insolvency proceeding. In *Re Wigzell*,[48] Younger J. explained:

> … in considering the extent of this particular jurisdiction it is quite vital to distinguish between a trustee not insisting or the Court not permitting him to insist on all the legal consequences of, on the one hand, a transaction initiated by himself or by the Court in the interests of the general body of creditors and on the other hand a transaction initiated by the bankrupt. In the first case the creditors are the constituents of the trustee throughout, and *as they are entitled to benefit by the transaction, so it does not seem to be wrong to say that they shall take it as it honourably is no more and no less*. But in the second case the bankrupt has no constituents—that is to say, the transaction is initiated by him presumably in his own interests alone—and it is not obvious that a creditor with whom that transaction has been carried out and is complete, even one who in relation to it may have been tricked by the bankrupt, has any equity at all as against the other creditors of the same bankrupt, who may all have been equally tricked, merely because in his case the proceeds of the transaction can be traced amongst the bankrupt's assets, and in the other cases they cannot …[49]

On Younger L.J.'s reasoning, *ex parte James* should be confined to transactions that are both initiated by the court officer *and* for the benefit of the creditors as a whole. If so confined, the constituents of the estate represented by that officer ought also in fairness to be subject to the honourable handling of such transactions, because a stricter extra-legal standard of conduct governs such court appointed officers. There are two immediate problems

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47 *Star v. Silvia, supra* note 30 at 14, *per* Young J.: "The principle should be applied to ensure that the liquidator does not hold property where there are claims of conscience against the property, without recognising those claims of conscience."; *Re Wigzell, supra* note 24 at 845 *per* Salter J.: "The effect of exercising the jurisdiction … is to deprive the creditors of money which is divisible among them by law. I feel sure that such a power should not be used unless the result of enforcing that law … would be pronounced to be obviously unjust by all right-minded men."

48 *Supra* note 24.

49 *Ibid.* at 869–870 [emphasis added].

with this. First, the requirement that the *ex parte James* principle applies only to the acts or omissions of the officer is the subject of conflicting authority. While recognised in some cases,[50] it has been rejected in *Re Thellusson*[51] and in *Re PCChip Computer*.[52] Second, only some of the cases applying *ex parte James* have explicitly taken into account a benefit to the administration of the estate.[53]

Even if we assumed this to be a necessary condition for the operation of the principle, there are two objections to the reliance on commercial morality or honesty as the explanatory force for *ex parte James' de facto* priority. First, it is manifestly unsatisfactory to rest insolvency priority on such vague and amorphous concepts. The oft-heard criticism is that the scope of the rule is "uncertain" and "difficult to apply",[54] and its application has been "spasmodic and irrational".[55] For example, in *PCChip Computer*, the court placed much weight on the fact that the unsecured creditors of the insolvent company would receive a windfall if the court did not order a refund of the mistaken payment to the bank.[56] Where a similar windfall occurred as a result of the bank's mistaken transfer out of the bankrupt's account, which was used to discharge some of the bankrupt's debts, Goulding J. in *Re Byfield*[57] took the opposite view:

> To my mind there is nothing offensive either to commercial or to general morality in the general body of creditors receiving a benefit—a windfall, if you will—from the bank's unfortunate payment in the present case, if there is no principle of statute law or of equity to restrain them.

As is to be expected, if priority is based on imprecise concepts, we can expect starkly inconsistent results in a context which can ill-afford such uncertainty. The use of morality runs directly against the grain of an important rationale for *pari passu* distribution—to avoid the cost and uncertainties of weighing the relative merits of individual claims on a case by case basis.[58]

Second, when the courts evaluate the circumstances to determine what morality dictates, it is submitted that they fudge two conceptually distinct issues: whether the claim ought to be recognised in spite of its non-provable status, and what priority it ought to receive. By simply asking what a

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50 For example: *Re Hall* [1907] 1 K.B. 875 at 879, *per* Farewell L.J.; *Downs Distributing Co. Pty. Ltd. v. Associated Blue Star Stores Pty. Ltd. (In liq.)* (1948) 76 C.L.R. 463 at 482, *per* Williams J.

51 *Supra* note 27 at 764 *per* Atkin L.J.

52 *Supra* note 3 at para. 32.

53 *Infra* note 116.

54 *Re Wigzell, supra* note 24 at 857–858, *per* Scrutton L.J.

55 *Re A.M. Drysdale*, *supra* note 1 at 277.

56 *Supra* note 3 at para. 39.

57 [1982] Ch. 267 at 271.

58 Vanessa Finch, "Is *Pari Passu Passé*?" [2000] Insolvency Lawyer 194 at 210.

right-minded and honest person would do in the circumstances, the courts have often focussed on an ethical evaluation of the officer's conduct from a purely *bilateral* perspective—the relationship between the officer and the claimant—when the interests affect by the *ex parte James* principle are also collective and multilateral in nature. Thus, for example, in *Re Thellusson*, the claimant lent the bankrupt a sum of money when both parties were ignorant of the fact that a receiving order had already been made. The claimant would not have lent the money had he known otherwise, and accordingly sought to recover the balance of the sum lent which was in the hands of the trustee in bankruptcy. By focussing on whether the bankrupt in the circumstances ought to have recognised the claim of the lender,[59] and transferring this moral obligation to the trustee in bankruptcy, the court failed to ask and address the consequential question—why should the claimant, even as a matter of commercial morality, stand ahead of the other creditors who ostensibly took the same risks vis-à-vis the bankrupt in extending him credit?

Re Thellusson also does not adequately consider the position in which the officer stands. It is his duty to take possession of the property of the insolvent, to realise it, and to distribute the proceeds *rateably* among the creditors of the estate.[60] It is also necessary to ask whether observing those standards would be consistent with the officer's duty to act fairly to all creditors constituting the insolvent estate.[61] Where there are additional collective concerns—how we value claims against each other in a collective proceeding where there are insufficient funds to satisfy all—the officer does not just deal with claimant as a quasi-litigant, but also on a collective footing. If he is duty bound to act impartially in the interests of all the creditors,[62] there ought to be a clear justification why, apart from recognising the otherwise non-provable claim as a matter of fairness, it ought also to receive full priority.

This is the reason why a claimant should not be able to submit an ordinary proof of debt if *ex parte James* is to apply. In *Re Gozzett*,[63] the bankrupt contracted with Messenger & Co. ("Messenger") to construct four greenhouses on his land. They also introduced him to a mortgage company to arrange financing for the project. Unfortunately for Messenger, a receiving order was made before the mortgage company released the loan to pay for Messenger's services. The trustee in bankruptcy was able to sell the land

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59 *Supra* note 27 at 751, 756 and 765.

60 *Re Treacy, supra* note 14 at 721.

61 This was recognised by Lord Sterndale M.R. in *Scranton's Trustee v. Pearse, supra* note 28 at 119–120, and by Murray Aynsley J. in *Re A.M. Drysdale, supra* note 1 at 276: "Why only the creditors of a bankrupt should be victims of high-mindedness is not explained."

62 *Pace v. Antlers Pty. Ltd.* (1998) 26 A.C.S.R. 490 at 501.

63 *Supra* note 18.

at an enhanced price. Messenger's reliance on *ex parte James* was however rejected:

> The real truth of the thing is they did the work on the footing that they were giving credit to a man to whom they thought it reasonable to give credit, … That does not seem to me to afford any justification for putting them into the same position as if they had done that which they could very well have done if they had been careful, and that is to put them into the position of a person with a security, a position in which they could very easily have put themselves and never in fact did.[64]

The same concerns were considered in *Re Elias Ayoub*,[65] where the claims were not provable. Suppliers granted credit to the bankrupt in ignorance of the making of the receiving order and they thus sought relief in *ex parte James*. The court, in contrast to *Re Thellusson*, did not think it would be:

> … unconscionable for the trustee to require the four creditors to pursue their rights under the Act to petition for a second bankruptcy. It is not to the point that the exercise of those rights may prove fruitless. *They ran the risk of doing business with the bankrupt, as did the creditors who have proved in the bankruptcy*. The Act proceeds upon the basis that debts proved against an estate are to rank equally except in special circumstances for which provision is made for priority payment … the court would not be justified in directing the trustee to pay out of the assets of the estate in priority to unsecured creditors the debts incurred to the four creditors.[66]

It therefore does not follow that if honesty and fairness require recognition of the claim from the perspective of bilateral honest dealing, statutory rules of proof notwithstanding, full priority should *ipso facto* be accorded. Unless there is some further legal or moral basis for insolvency priority, the claim should not rank ahead of other unsecured creditors. The guidelines enunciated in *Re Clark,* which exclude provable claims from the ambit of *ex parte James*, suggest that if there is indeed a valid reason for priority, it is to be found in the status of the claimant as a *post*-insolvency creditor. This brings us to the next rationale for priority.

V. The Liquidation Expenses Principle—Benefit to Creditors

One commentator has suggested that the claim for recovery of benefit under the rule be seen as, or as analogous to, a cost or expense of liquidation.[67]

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64 *Ibid.* at 85.
65 (1983) 67 F.L.R. 144.
66 *Ibid.* at 149 [emphasis added].
67 Lee Eng Beng, "Insolvency Law" (2001) 2 S.A.L. Ann. Rev. 239 at 245.

Generally speaking, liquidation expenses are incurred post-insolvency, and hence payable, not provable.[68] The priority conferred on liquidation expenses stems not so much from some vague standard of honourable conduct imposed on judicial officers, but rather "a community of interest in having a common agent maximise a fund for distribution among them".[69] Flowing from the collective nature of the proceedings, there appear to be two aspects of this common interest at play in conferring insolvency priority on such claims. The first is a pragmatic one. Priority acts as some incentive for new creditors to transact with the insolvent estate, where their goods or services are necessary in promoting the important policy objective of maximising the value of the estate.[70] This is potentially useful where the insolvent estate is not in a position to offer such creditors any security for their claims. Secondly, priority can in part be seen as an expression of fairness.[71] If post-insolvency creditors have in fact benefited the insolvent estate, it should not be able to take the benefit contributed by such creditors without bearing such liabilities in full. These considerations suggest that only liabilities *necessary* for the *beneficial* winding up of the company ought to be preferred.

This is borne out in some legislative provisions like s. 556(1)(a) of the *Australian Corporations Act 2001*, which limits expenses to those that have been "properly incurred by a relevant authority in preserving, realising and getting in property of the company, or carrying on the company's business". Other more generally worded provisions like s. 328(1)(a) of the *Companies Act*[72] ("CA") only refer to priority for "costs and expenses of the winding up". The case law has nevertheless interpreted this phrase to cover expenses that are properly incurred in the course of the winding up or, more specifically, in the realization of the insolvent company's assets.[73] Such expenses

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68 *Re Toshoku Finance U.K. Plc.* [2002] 1 W.L.R. 671 at para. 25, *per* Lord Hoffmann.

69 Australian Law Reform Commission, General Insolvency Inquiry, Report No. 45 (1988—Harmer Report) at para. 717; *Re Universal Distributing Co. Ltd. (in liq.)* (1933) 48 C.L.R. 171 at 174.

70 *In re Mammoth Mart Inc.* 536 F. 2d 950 at 954 (U.S.C.A., First Circuit, 1976).

71 G. Moss and N. Segal, "Insolvency Proceedings: Contract and Financing" (1997) 1 C.F.I.L.R. 1 at 9.

72 (Cap. 50, 1994 Rev. Ed. Sing.). See also s. 90 BA.

73 *Re Beni-Felkai Mining Co.* [1934] Ch. 406 at 409, *per* Maugham J.: "The term is not one of art and I see no reason why it should not include any expenses which the liquidator might be compelled to pay in respect of his acts in the course of a proper liquidation of the company's assets"; *Pace & Anor v. Antlers Pty. Ltd.* (in liq.) (1998) 26 A.C.S.R. 490 at 508: "In my view, the amount of that liability would have been a cost or expense of the winding up for the purposes of s. 292(1) of the *Companies Act 1961* (N.S.W.). It would have been a liability incurred by Mr Millar in the course of, and by reason of, the winding up and by reason of his position as liquidator." See also *K.D. Morris & Sons Pty. Ltd. (in liq.) v. Bank of Queensland Ltd.* (1980) 5 A.C.L.R. 144.

are not confined to contractual liability, but have been held to include rate and tax liability as well.[74]

In determining what constitutes such an expense, there is no necessity that the officer personally incur the liability. She can confer liquidation expense status on liabilities that, although accruing during the insolvency proceedings, arise out of pre-liquidation transactions by adopting them in accordance with the *Lundy Granite Co.* principle.[75] This is so notwithstanding that such future liabilities are provable in the relevant insolvency proceedings.[76] The extension covers liabilities incurred before the liquidation in respect of property afterwards retained by the officer for the benefit of the insolvent estate.[77] Moss and Segal conclude that the officer makes an "adoption" when he objectively accepts performance or uses property under the relevant transaction for the purposes of the insolvency proceeding.[78]

It is submitted that a number of cases within the *ex parte James* fold can be better explained on this rationale for priority. In *Re Tyler*,[79] the wife of the bankrupt kept up the premium payments on his life insurance policy at his request prior to the receiving order. These were continued well into the bankruptcy to the knowledge of the trustee. The trustee would have been bound, if the funds were available to the estate, to meet the premiums on the policy as it would be worth more than the premiums if the life dropped. Consequently, the case can simply be seen as recognising that her restitutionary claim for reimbursement of the payments was in fact in the nature of bankruptcy expenses. The trustee should not have been allowed to take the benefit of the policy proceeds on behalf of the bankrupt's estate without recognising the wife's claim for the premiums paid, which preserved the value of the asset. Although it is not pertinent here to speak of providing the wife with an incentive to deal with the estate, this is probably not an essential prerequisite for priority. After all, third parties to contracts adopted for the purposes of the insolvency proceedings are bound to perform their obligations if the court officer chooses to adopt the contract. Nor is the language of incentive used in recognising rate and tax claims as liquidation expenses. The benefit rendered to the estate, not merely the bankrupt, is clear. An admitted aberration in this analysis, however, is the court's failure to distinguish between the wife's pre and post-bankruptcy payments. The former, strictly speaking, could not be conferred priority

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74 *Re Blazer Fire Lighter Ltd.* [1895] 1 Ch. 402; *Re Beni-Felkai Mining Co. Ltd., supra* note 73.

75 See *Re Lundy Granite Co., ex. p. Heavan* (1871) L.R. 6 Ch. App. 462; *Re Oak Pits Colliery* (1882) 21 Ch.D. 322.

76 See s. 87(3)(b) BA.

77 *Re Toshoku Finance U.K. Plc., supra* note 68 at para. 29.

78 *Supra* note 71 at 12–13.

79 *Supra* note 11.

since the benefit, as in the case of other pre-bankruptcy creditors, was conferred on the bankrupt rather than his estate in bankruptcy, and should have ranked *pari passu*.

Another example arises where a creditor continues to trade with the bankrupt in ignorance of the making of the relevant order. In *Re Clark*,[80] the bankrupt, who managed a licensed petrol station, continued to receive petroleum supplied from Texaco Company ('Texaco') after a receiving order was made. Both parties were ignorant of the making of that order. Nevertheless, Walton J. reasoned that as the trades occasioned by those supplies were beneficial to the bankrupt estate, the trustee should not pursue his right to recover two of the payments for petroleum made post-bankruptcy, being void dispositions of the bankrupt's property.[81] Applying the liquidation expense principles set out above, the trustee adopted Texaco's beneficial transactions with the bankrupt by negotiating for the sale of the business, including the remaining stock on the premises, as a going concern. In the alternative, the trustee could simply have returned the unused stock and unraveling the transactions made pursuant to the dealings with Texaco. What he should not have been permitted to do was pursue both courses of action. The court was thus right in dismissing the action to reclaim the sums actually paid out to Texaco after the making of the receiving order. Consequently, these expenses were entitled to the *de facto* priority accorded even though they were not entered into with the authority of the trustee.

In contrast, *Re Elias Ayoub*[82] represents a rather harsh decision. Status as liquidation expenses was rejected as the relevant statutory provisions required that the transactions be entered into with the authority of the liquidator.[83] An appeal to *ex parte James* was similarly rejected on the grounds, *inter alia*, that there was no agreement between the liquidator and the claimants in question that their debts were to be paid in full. Consequently, the court reasoned, there was nothing to distinguish these post-bankruptcy creditors on the ground that their debts were incurred for the benefit of the estate. Nonetheless, the business of the bankrupt which the post-bankruptcy debts related to was only begun after the sequestration order. The stock-in-trade of this business was comprised almost entirely of the liquor and equipment supplied by these claimants. Notwithstanding that the trustee sold this very same business as a *going concern* for a sizeable sum, the claimants were not entitled to even lodge a proof in the bankruptcy, but were relegated to their right to share in the speculative spoils of a second

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80 *Supra* note 13.
81 *Ibid.* at 462.
82 *Supra* note 65 and accompanying text.
83 Section 109(1)(a) *Bankruptcy Act 1966* (Cth.) and Rule 40(a) *Bankruptcy Rules* (Cth.).

bankruptcy. In the light of the rationale for liquidation expense priority, they ought in fairness to have had their claims recognised and accorded priority for in fact conferring a substantial benefit on the estate. This benefit was also adopted by the trustee when he continued the business thereafter and sold it. The result is perhaps explicable on the basis of the court's disinclination to subvert the express wording of the particular statutory provision by allowing recourse to *ex parte James.* Nevertheless, it is respectfully submitted that the court could, at the very least, have allowed the claimants to enter proof in the instant bankruptcy.

The upshot thus far is that the liquidation expenses rationale provides a clearer justification for the priority conferred pursuant to *ex parte James* decisions in several instances, particularly where the facts demonstrate that the insolvent estate should not to be allowed to take advantage of the benefit conferred by post-insolvency claimants without bearing the burden of such liabilities. It is in the unsecured creditors' collective interest that such claims are met in full, at least where there is *in fact* a demonstrable benefit accruing to the estate.

How would this analysis apply to claims for the recovery of mistaken payments—exemplified in *ex parte James* and *Re PCChip Computer*? In the cases applying the liquidation expenses principle above, the liability in question arose as necessary consequence of some act taken by or on behalf of the officer in pursuance of the administration of the insolvent estate.[84] Mistaken payor claimants relying on *ex parte James* will however find themselves in a predicament because it would be difficult to argue that their mistaken payments are necessary for the beneficial administration of the estate, or a *necessary* consequence of some voluntary conduct of the officer. Rather, it is the payor's own mistaken assumptions regarding the insolvent individual or company that give rise to the claim. Furthermore, the "benefit" that results is the swelling of the insolvent estate's assets by the value of the mistaken payment. If priority is recognised on the basis of a "benefit" to the estate, this very "benefit" would simply be returned in its entirety, leaving the estate ambivalent to the claim. It also follows from this that the concept of adoption is inapposite unless it can some how be shown that the mistaken payments *per se* were used for the purposes of the insolvency proceedings.[85] Therefore, the absence of any necessary connection with the administration of *or* benefit to the insolvent estate leads us to wonder if there is some other reason why these particular post-insolvency claims ought to receive priority status.

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[84] *Supra* note 73.

[85] Moss and Segal, *supra note* 71 at 13.

VI. Fairness to Post-Insolvency Creditors

A second footing on which claims have been conferred priority under the "liquidation expense" rubric, albeit for rather different reasons, emerges from U.S. authorities. Recall the distinction made in *ex parte Clitheroe*[86] between pre- and post-insolvency creditors. Given this chronological bifurcation of debts and liabilities, are *all* debts and liabilities that arise after the making of the relevant insolvency order *ipso facto* accorded "liquidation expense" status—even if these debts and liabilities do not satisfy the requirements identified above for priority?

On this point, a more expansive doctrine of liquidation expenses[87] emerges from the U.S. Supreme Court decision in *Reading Co. v. Brown*.[88] There, an insolvent company had filed a petition for arrangement under Chapter XI and a receiver was appointed. As a result of the negligence of the receiver and his employee, a fire occurred which destroyed a building that was the company's only significant asset, as well as real and personal property of Reading Company. It filed a claim for damages and sought administrative expense priority for this under section 64(a) of the Bankruptcy Act.[89] The Supreme Court held that s. 64(a) also offered protection to claimants that are injured by the insolvent estate's operation of the business—even if their claims did not arise from transactions that were necessary to preserve or enhance the value of the estate. Harlan J., writing for the majority, reasoned:

> At the moment when an arrangement is sought, the debtor is insolvent. Its existing creditors hope that by partial or complete postponement of their claims they will, through successful rehabilitation, eventually recover from the debtor either in full or in larger proportion than they would in immediate bankruptcy. *Hence the present petitioner did not merely suffer injury at the hands of an insolvent business: it had an insolvent business thrust upon it by operation of law*. That business will, in any event, be unable to pay its fire debts in full. But the question is whether the fire claimants should be subordinated to, should share equally with, or should collect ahead of those creditors for whose benefit the continued operation of the business (which unfortunately led to a fire instead of the

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86 *Supra* note 37.

87 Or "administrative expenses" as it is known in the U.S. Bankruptcy Code: see 11 U.S.C. §503 (1978).

88 391 U.S. 471 (1968).

89 11 U.S.C. §104(a) (1898): "The debts to have priority, in advance of payment of dividends to creditors, and to be paid in full out of bankrupt estates, and the order of payment, shall be (1) the costs and expenses of administration, including the actual and necessary costs and expenses of preserving the estate subsequent to the filing of the petition …"

> hoped-for rehabilitation) was allowed … The "master" liable for the negligence of the "servant" in this case was the business operating under a Chapter XI arrangement for the benefit of creditors and with the hope of rehabilitation. That benefit and that rehabilitation are worthy objectives. But it would be inconsistent both with the principle of *respondeat superior* and with *the rule of fairness in bankruptcy* to seek these objectives at the cost of excluding tort creditors of the arrangement from its assets, or totally subordinating the claims of those on whom the arrangement is imposed to the claims of those for whose benefit it is instituted.[90]

He later concluded:[91]

> … we are persuaded that it is theoretically sounder … to treat tort claims arising during an arrangement as actual and necessary expenses of the arrangement rather than debts of the bankrupt. In the first place, in considering whether those injured by the operation of the business during an arrangement should share equally with, or recover ahead of, those for whose benefit the business is carried on, *the latter seems more natural and just. Existing creditors are, to be sure, in a dilemma not of their own making, but there is no obvious reason why they should be allowed to attempt to escape that dilemma at the risk of imposing it on others equally innocent.*

Thus tortious claims or tax liabilities that arise as a result of the insolvent estate's business operations are seen as instances where "fundamental fairness" require that the post-insolvency claimant's right to payment takes precedence over the rights of general unsecured creditors, even where no discernible benefit results to the insolvent estate.[92] The Court was also concerned that any other result would not internalise the costs of the liability and fail therefore to offer adequate incentive for the insolvent estate to insure against the contingencies that materialised in that case.[93]

The reasoning of the majority in *Reading Co. v. Brown* proceeds on the implicit view that at the commencement of the insolvency proceedings, a fundamental change occurs that alters the nature of the enterprise, rendering it legally and morally distinct from the entity that previously existed. Since this new "creature" is created for the sole benefit of the existing unsecured creditors, they ought to stand on a lesser footing than new creditors who suffer loss as a result of the operations of that new creature.[94] Jackson

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90 *Supra* note 88 at 478–479 [emphasis added].

91 *Ibid.* at 482–483 [emphasis added].

92 *Re Hemingway Transport, Inc.* 993 F.2d 915 (1st Cir. Mass, 1993) at 929 fn.17.

93 *Supra* note 88 at 483–484.

94 D.R. Korbkin, "Rehabilitating Values: A Jurisprudence of Bankruptcy" (1991) 91 Colum. L. Rev. 717 at 785.

likens this transition to the conversion of pre-insolvency creditors into equity stakeholders in the new entity by operation of law.[95] They ought therefore to bear the risks of any further costs, expenses or liability incurred by the insolvent entity. Hurd supplements this argument as follows:

> The Court recognized that absent a governmentally sanctioned arrangement, the debtor likely would have already lost the real estate to a solvent claimant through state debt-collection law, and thus a fire such as this one could be compensated for by insurance and the new owner's assets. The concern was not that the arrangement in any way made the debtor more dangerous, but that it represented a governmental decision to allow continued operations with full knowledge that those injured in these operations would have zero recovery.[96]

Detractors like Jackson have argued that the analogy is weak. He offers a competing portrait of this dilemma concerning the treatment of post-liquidation claims in which the relevant insolvency order merely *commences* the dissolution of the insolvent entity. This dissolution only concludes at the end of the insolvency proceedings where distributions are made to the creditors either by way of dividends from the liquidation or new shares in a reorganized business. It is only at this point that unsecured creditors of the insolvent company become equity stakeholders in any real sense of undertaking anew the risk of insolvency and hence, subordination to the claims of subsequent new creditors of that entity.[97] Essentially, he sees such proceedings as continuing negotiations between management, equity and creditors, albeit with statutory sanction. Since it is the same historical business entity which post-liquidation creditors like Reading Company are subject to, there is no compelling reason why they should be treated any differently. Thus Warren C.J., dissenting in *Reading Co. v. Brown*, argued:

> … a business in arrangement is no more thrust on the public than is any other business enterprise which is conducted for the mutual prosperity of the owners, the wage earners and the creditors. Realistically, the only difference is that a business administered under Chapter XI has not been prosperous. If the arrangement is successful, the owners, wage earners and creditors will all benefit; if it is not, they will all be injured. Thus, I would not distinguish in this case between petitioner [post-bankruptcy

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95 T.H. Jackson, "Of Liquidation, Continuation, and Delay: An Analysis of Bankruptcy Policy and Nonbankruptcy Rules" (1986) 60 Am. Bankr. L.J. 399 at 425.

96 S.D. Hurd, "Re-reading Reading: 'Fairness to All Persons' in the Context of Administrative Expense Priority for Postpetition Punitive Fines in Bankruptcy" (1998) 51 Vand. L. Rev. 1459 at 1469–1470. There would be zero recovery as actions based on such torts would not be provable debts as they could not have been instituted prior to the filing of the petition of bankruptcy: 11 U.S.C. §103(a) (1898).

97 Jackson, *supra* note 95 at 425–426.

> tort claimant] and the other general creditors, none of whom was responsible for the catastrophe for which all of them must sustain some loss. Instead, in deciding this case, *I would adhere to the Act's basic theme of equality of distribution*.[98]

Furthermore, if creditors in negotiations with management or *inter se* over the dissolution of the same business entity outside of insolvency would have to accept the risk of newly accruing liabilities during the ensuing delay before any final distribution is made, then these costs should not be imposed on them in the insolvency proceedings. Otherwise, such distortions between the treatment of claims in and out of the formal insolvency proceedings would create disincentives for resorting to such proceedings, and result in corresponding loss of value.[99]

It is submitted that the resolution of this issue is largely dependent on a close examination of the nature of the particular insolvency proceedings in question, and consequently the nature of the risks accepted by pre- and post-insolvency creditors. The criticisms of Jackson and the minority in *Reading Co. v. Brown* are based largely on the negotiation model of the current U.S. Bankruptcy Code Chapter 11 or its predecessor arrangement process. This has often been described as a framework for bargaining over the hypothetical sale of the business to pre-existing creditors.[100] Central to this model is the provision for a debtor-in-possession regime where management remains in control of the business throughout the formal insolvency process ("debtor-in-possession").[101] Pre-petition creditors thus continue to accept the risks of strategic behaviour on the part of the debtor-in-possession, who very often may well continue to take into account their own interests and that of existing shareholders.[102] Although there is judicial supervision over the debtor-in-possession, it is submitted that this does not substantially detract from the negotiation model, and the implications for post-insolvency creditors argued for by Jackson, particularly in the light of the continued agency costs that pre-insolvency creditors bear in allowing management to remain in control.

Contrast this with a liquidation model like winding-up under the CA, where almost complete control is handed over to creditors, *inter alia*, by the appointment of external management over the business[103] (the liquidator)

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98 *Supra* note 88 at 488 [emphasis added].

99 Jackson, *supra* note 95 at 426.

100 D. Baird, "The Uneasy Case for Corporate Reorganizations" 15 J. Legal Stud. 127 (1986) at 127–128.

101 11 U.S.C. §§1101, 1104, 1107 (1978).

102 For a summary of these concerns, see M. Bradley and M. Rosenzweig, "The Untenable Case for Chapter 11" (1992) 101 Yale L.J. 1043 at 1045–46.

103 Sections 263, 269 and 272 CA.

and creation of committees of inspection.[104] The liquidator is a court appointed officer who shall have regard to the resolutions of the pre-insolvency creditors meeting or committee of inspection,[105] and must act impartially in the interests of the pre-insolvency creditors.[106] This regime adheres far more closely to the "new business entity" model postulated by the majority in *Reading Co. v. Brown* that is "thrust" on post-insolvency creditors by operation of law. Pre-insolvency creditors, whether through the appointment of the liquidator, or through the agency of a committee of inspection, have comparatively greater protection than in a U.S. Chapter 11 bankruptcy filing. Consequently, although there may be distortions created by recognising priority for post-insolvency claimants injured by the operation of the post-liquidation business or process of dissolution, it can be argued that this is the *quid pro quo* for eliminating the strategic costs of leaving management in place and replacing it with a creditor-centric system of insolvency management.

Thus, by reason of the transfer of control to pre-insolvency creditor constituents on the creation of the insolvent estate, post-insolvency creditors do not stand on the same footing. The fundamental fairness recognised in *Reading Co. v. Brown* would require priority for the latter who are injured by the continued operation of that entity.[107] The assumption of insolvency risk by these claimants differs from pre-insolvency creditors not so much by reason of the *nature* of their claims against the business entity, but rather the *identity* of that entity—the statutorily created insolvent estate in bankruptcy[108] or winding up.[109] An additional reason to recognise such post-insolvency priority is that it internalises the full costs of the

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[104] Sections 277–278 CA (compulsory winding up) and s. 298 CA (creditors' voluntary winding up).

[105] Section 273 CA; Rule 124, *Companies (Winding Up) Rules* (1990 Rev. Ed. Sing.) provides that a creditor may not vote unless his proof of debt has been admitted, implicitly excluding post-insolvency creditors from voting at creditors' meetings.

[106] *Re G. K. Pty. Ltd. (in liq.)* (1983) 7 A.C.L.R. 633 at 639.

[107] The rationale for liquidation expense priority would hold true for either model of the insolvency proceedings, as long as such liabilities are necessary for the benefit of the insolvent estate.

[108] Section 76(1)(a) BA vests the property of the bankrupt in the Official Assignee ("OA"), without any further conveyance, assignment or transfer, to be divided among his creditors. In this respect, s. 76(1)(b) constitutes the OA as receiver, and it is his duty as fiduciary to protect, get in, realise and ultimately pass on assets which belong to the pre-bankruptcy creditors: *Mirror Group Newspapers Plc. v. Maxwell & Ors.* [1998] B.C.C. 324 at 333. Further, the OA or trustee in bankruptcy "… shall, as far as practicable, consult the creditors with respect to the management of the bankrupt's estate, …": ss. 22(2) and 36(1) BA; see also s. 23(2) BA. Thus, it is submitted bankruptcy proceedings similarly create a fundamentally different estate for the purposes of the management and realisation of what were previously the individual debtor's unencumbered assets.

[109] *Ayerst (Inspector of Taxes) v. C. & K. (Construction) Ltd.* [1976] A.C. 167 at 177.

post-insolvency activity of the estate.[110] Pre-insolvency creditors, through their appointed representative, have greater means relative to pre-insolvency creditors to ensure that these are catered for and minimised where possible.

What is the relevance of this broader basis of priority, unconstrained by requirements of necessity or the conferral of benefit, for claimants seeking the recovery of mistaken payments? Although the basis of the claim lies in unjust enrichment rather than compensation for a wrong suffered, a rationale based on the creation of a distinct insolvent estate in *Reading Co. v. Brown* suggests that this should not make a difference in the treatment of this particular species of post-insolvency claims. It is submitted that the real difficulty is whether we should also use the date of accrual of the cause of action underlying such claims as the litmus test to distinguish between pre- and post-insolvency claims. It seems counter-intuitive that every claim that happens to accrue post-insolvency should automatically be conferred priority on this basis. This concern is borne out in *Re Denton Sub-Divisions Pty. Ltd.*,[111] where Street J. disallowed priority for costs incurred by an investigation of the company ordered under the provisions of a different statute. The court held that the costs did not accrue during the course of the instant winding up (even though this was true in point of time) as these must be capable of being seen to relate to anything existing at the commencement of the winding up or anything done during the course of that winding up.[112]

In the normal course of insolvency proceedings, there may be a delay in the officer getting custody of the assets or giving notice of the insolvency proceedings to third parties. In the mean time, post-insolvency creditors may still think they are dealing with the historical person or company. Claims may also arise by reason of the prior activity of that person or company, not the insolvent estate. It cannot fairly be said that such creditors, even if they are in point of time post-insolvency creditors, should only assume insolvency risk vis-à-vis the newly created entity and not its historical antecedent. They have not *per se* been affected by the existence or administration of the insolvent estate. Therefore, adapting the reasoning in *Re Denton*, it is suggested that claims relating to mistaken payments should only be conferred priority on this basis if they (a) arise post-insolvency and (b) have sufficient causal nexus with the activities of the estate. If the claim for recovery of a mistaken payment arises prior to the commencement of the relevant insolvency proceeding,[113] or is solely the result of dealings with the antecedent entity,[114] there is insufficient nexus and the general norm of *pari passu* distribution should apply to such unsecured creditors as well. However, if

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[110] *Supra* note 88 at 483, *per* Harlan J.

[111] (1968) 89 W.N. (Pt. 1) (N.S.W.) 231.

[112] *Ibid.* at 234.

[113] As it was in *Re Pinkroccade, supra* note 4.

[114] This would suggest that *Re Thellusson* was, with respect, wrongly decided.

the causative event for the mistaken payment was the conduct of the insolvency proceedings, priority should attach. The facts in *ex parte James* itself, where the mistaken payment was made in response to the unlawful demand of the trustee in bankruptcy, would fall squarely within this justification for priority.

In *PCChip Computer*, the over-credit of the company's account occurred well before the winding up pursuant to an error in the bank's computer system. But the actual mistaken payment only occurred when the liquidators called for the monies remaining in the account. Although a much closer call, it is submitted that the claim in that case should also be seen as an incidental liability incurred as a direct result of calling in the assets of the company. In contrast, there may conceivably be payments or other enrichments that are based on mistakes made without any causal connection with the existence and activities of the insolvent estate. For example, adapting the facts of *Re Pinkroccade*, the mistake leading to an overpayment may result solely from dealings with the antecedent company before it went into winding up, but the payment only received during winding up. In such a case, the date of accrual of the cause of action is fortuitous and should not be a basis to distinguish the claimant from pre-insolvency unsecured creditors.[115]

VII. Non-Insolvency Justifications

Neither the liquidation expenses principle nor the idea of fairness to post-insolvency claimants has been explicitly used in the case law to justify the *de facto* priority in *ex parte James*.[116] In *Hartogen Energy Ltd v. Australian Gas Light Company and Others*, Gummow J. conducted a survey of the case law and personally thought that the doctrinal basis of the rule in *ex parte James* was better placed in the law as to the recovery of mistaken payments, although he did concede that the case law had proceeded well beyond these limits.[117] This view has been taken up in the literature, with Dawson arguing that *ex parte James* was decided at a time when the law of restitution was in its early stages of development.[118] Given its close parallel with

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[115] This analysis appears contrary to *PCChip Computer, supra* note 3 at para. 32, where Lee J.C. rejected any requirement that the mistaken payments must be connected with the conduct of the liquidators. Through the lens of the broader post-insolvency priority rationale discussed above, it is submitted that this could be interpreted as merely disavowing any requirement that the insolvent estate and its management must be responsible for the operative mistake on the part of the payor.

[116] The idea of benefit rendered by the post-insolvency claimant has however been considered in the context of determining the requirements of honesty and commercial morality: see *Re Clark, supra* note 13 and accompanying text, and *Star v. Silvia, supra* note 30 at 13–14.

[117] *Supra* note 32 at 192.

[118] Ian Dawson, "The Administrator, Morality and the Court" [1996] J.B.L. 437 at 454–458.

the requirements for a claim in unjust enrichment, there would be several doctrinal advantages gained by subsuming the principle in *ex parte James* into that body of law, foremost being the removal of the need for judges to administer rules of ethics. Although it does put the initial core of the rule on a firmer juridical footing, Dawson's thesis does not address the issue of priorities. This question has, however, been indirectly addressed by several other commentators that look at the problem from a more general perspective of a valid doctrinal basis of priority for claims for recovery of mistaken payments.[119]

These approaches take us out of the confines of insolvency proceedings and into the realm of general law priority based on the nature of the underlying claim. A consideration of the merits of such approaches is beyond the scope of this article, but three instances of incongruence with the principle in *ex parte James* can be raised here. First, representative of the current thinking on general law priority for the recovery of mistaken payments is Sherwin's thesis, which advocates priority on the grounds that (a) the insolvent payee obtained an unjust gain at the claimant's expense, (b) the claimant can identify the gain among the assets claimed by general creditors, and (c) the claimant did not voluntarily extend credit to the payee.[120] The second requirement of non-provability in *Re Clark* does not sit well with this thesis, since it requires that the enrichment in question must have occurred after the relevant insolvency order, whereas this is immaterial under the Sherwin thesis. It would promote an arbitrary distinction between such claims on the basis of their date of accrual. Thus, in *PCChip Computer*, the payment fell within the ambit of the *ex parte James* because the mistake recurred when the liquidator instructed the bank to transfer the proceeds of the mistakenly over-credited account, giving rise to a post-insolvency petition claim which was not provable. It is not apparent why this fortuitous act should drastically change the remedial complexion of the claim under general law, nor is there any good policy reason why, *ceteris paribus*, the same claim affords different remedial consequences depending on when it arose during the course of the payee's existence. Such a distinction only makes sense under the fairness to post-insolvency creditors rationale.

Second, and in a similar vein, the limitation of *ex parte James* to proceedings involving court appointed officers, and not others,[121] is also questionable since it is the qualities of the claim, not the nature of the office

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[119] E. Sherwin, "Constructive Trusts in Bankruptcy" (1989) University of Illinois Law Rev. 297; A. Kull, "Restitution in Bankruptcy: Reclamation and Constructive Trust" (1998) 72 Am. Bankr. L.J. 265.

[120] Sherwin, *ibid.* at 339–340. See also Kull, *ibid.* at 282–285.

[121] *Re T.H. Knitwear (Wholesale) Ltd.* [1988] Ch. 275; *Re Pinkroccade, supra* note 4 at para. 12; *Cf. Re Autolook Pty. Ltd.* (1983) 8 A.C.L.R. 419.

of management, that should confer priority. Apart from the Sherwin thesis and arguments based on general law rights and remedies, this particular limitation to *ex parte James* also creates an artificial distinction between the different forms of insolvency proceedings and may encourage unnecessary and wasteful forum shopping between different regimes in order to enable a claimant to invoke the rule.[122]

Third, the Sherwin thesis emphasises the relative standings of the claimant vis-à-vis other unsecured creditors, particularly the absence of a voluntary acceptance of the risk of insolvency on the part of the former. As pointed out above, the requirements of honesty and fair-dealing have *not* insisted on this, nor made the clear distinction between provability of the debt and the priority accorded to it. *Re Thellusson*, for example, cannot be justified on this basis as the claimant there in fact made the loan in order to assist the debtor in avoiding bankruptcy. Their common mistake as to the non-existence of the receiving order should not distinguish his claim for recovery from the debtor's other unsecured creditors who undertook a similar credit risk. The case also cannot come within the liquidation expenses rationale as there was no demonstrable benefit or adoption by the liquidator, nor the fairness to post-insolvency creditors' rationale as there was no causal link between the loan and the existence or activities of the insolvent estate. What then should be done in such cases?

VIII. A Discretion to Admit to Proof?

The foregoing discussion raises the spectre of situations where post-insolvency claimants are left without any real remedy. Claims may arise because the claimants and debtors were both unaware of the commencement of insolvency proceedings, but the requirements for priority on the basis of the liquidation expenses principle or post-insolvency status are not satisfied. Alternatively, claims may arise in connection with the debtor's activities, not the insolvent estate's, and yet not be provable by reason of the nature of the underlying cause of action and the date it accrues. Such unfortunate claimants would be left in limbo by the rules of proof to absorb the loss themselves.

Post-insolvency creditors of a bankrupt individual have the option of petitioning for a second bankruptcy even while the debtor remains an undischarged bankrupt, presumably provided leave to petition is obtained under s. 76(1)(c) BA. In a second bankruptcy, the post-insolvency creditors are entitled to look to the after acquired assets for a *pari passu* satisfaction of

[122] Dawson, *supra* note 118 at 454.

their claims, provided these assets have not yet been distributed to the first set of creditors.[123] There are, however, substantial drawbacks to this recourse. The value of the remedy is dependent entirely on whether substantial assets are acquired by the debtor during the midst of his pending bankruptcy, and is thus likely to prove speculative. Secondly, the post-insolvency creditor may not be able to satisfy the quantum of debt threshold.[124] Even if he could, the sums due may not justify the cost of a separate set of proceedings. Furthermore, such a remedy is non-existent in winding up proceedings.[125]

Nevertheless, as Harlan J. and Warren C.J. in *Reading Co. v. Brown* both recognised,[126] apart from conferring priority or complete exclusion, there is the third option of allowing the post-insolvency creditor to rank equally with other pre-insolvency creditors. Here, the *ex parte James* principle, in the sense of the court's jurisdiction to direct officers of the insolvent estate, could be used as a mitigation of the strictures of the proof of debt rules. A fairer solution in *Re Thellusson* may have been to allow the claimant to enter proof of his debt and rank equally with pre-insolvency unsecured creditors, since he extended credit under not dissimilar circumstances. It is suggested that discretionary override of the chronological limits to proof of debt may be allowed where the claimant confers credit or a benefit enriching the insolvent estate in good faith and in substantial ignorance of the institution of insolvency proceedings. This approach would also give due recognition the express limitation prescribed by s. 87(2) BA[127] concerning creditors with notice of the presentation of the bankruptcy petition. For example, in *Re Roberts,*[128] the court declined to confer a discretionary remedy under *ex parte James* on the ground, *inter alia*, that the lender knew of the imminent bankruptcy proceedings against Roberts. Finally, as alluded to above, the court would have to take into consideration the feasibility of the claimant, in bankruptcy cases, petitioning for a second bankruptcy.[129]

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123 Section 97(2) BA. In this respect, it seems that creditors of the second bankruptcy are to rank *pari passu* with the creditors of the first or preceding bankruptcy in respect of the unsatisfied portion of the latter's debts: s. 97(1) BA.

124 See s. 61(a) BA read with Reg. 2 of the *Bankruptcy (Variation of Minimum Amount of Debt for Petition for Bankruptcy) Order 1999* S.301/1999.

125 *Wight v. Eckhardt, supra* note 35 at para. 27.

126 *Supra* notes 90 and 98, and accompanying text.

127 Section 87(2) BA provides: "A person having notice of the presentation of a bankruptcy petition shall not prove under the bankruptcy order made thereon for any debt or liability contracted by the bankrupt subsequently to the date of his so having notice." This limitation is imported into the winding up regime by s. 327(2) CA.

128 (1976) 12 A.L.R. 730.

129 This was the case in *Re Elias Ayoub, supra* note 65.

IX. Conclusion

The principle in *ex parte James* provides a rather unsatisfactory solution to the problems raised by post-insolvency claims against an insolvent estate. James L.J.'s broad formulation of the rule has extended its application well beyond its initial concern with payments made under a mistake of law to other forms of enrichment. In the process of development, the doctrine has conferred insolvency priority without adequate justification or clear guidelines as to when this should be so. Instead, the use of the uncertain boundaries of honesty or commercial morality has blurred the real issues that need to be addressed when a claimant invokes *ex parte James*. It has been argued that the liquidation expenses or fairness to post-insolvency creditor rationales offer a better way of reinterpreting many such cases. They pinpoint the reasons for the priority conferred with greater clarity—a benefit to or adoption by the insolvent estate, or the very nature of that insolvent estate as a distinct entity from the antecedent debtor. Apart from these situations, it is questionable if there should exist such a fluid jurisdiction altering claim priority in the face of a clear statutory order of distribution. The fundamental basis of insolvency proceedings that binds all unsecured creditors to act together—the *pari passu* principle of distribution—clearly requires otherwise. Of course, if the claimant is able to establish some proprietary interest or remedy based on general, not insolvency, law, he is entitled to stand aloof of such proceedings. Finally, in those cases where priority is not justified, *ex parte James*—as a manifestation of the inherent jurisdiction of the court to direct officers administering insolvent estates—could still be used as a limited remedy for creditors who fall through the procedural cracks. Their claims may be still be recognised for the purposes of distribution even when not formally provable, unless the relevant statutory provisions clearly exclude them as a matter of interpretation.