

Court intervenes in a commercial party's discretionary powers

The recent decision in *BHL v Leumi ABL Ltd* [2017] EWHC 1871 (QB) illustrates the courts' willingness to scrutinise and challenge the exercise of a commercial party's discretionary powers. Here, the court intervened in the discretion which it considered the lender ought to have exercised when setting contractual charges.

Background

In 2008, Cobra Beer Limited (“Cobra”) entered into a Receivables Finance Agreement (“RFA”) with the Defendant in these proceedings Leumi ABL Limited (a subsidiary of Bank Leumi (UK) Plc). In 2009, Cobra entered into administration and substantial sums were due to it by its customers but it in turn, also owed substantial sums to Leumi under the RFA.

Following some restructuring of the Cobra business following its administration, business continued and BHL, the Claimant in these proceedings, became a shareholder of a new separate company which had been established (Cobra Beer Partnership Limited). In addition, BHL entered into an indemnity agreement pursuant to which it agreed to indemnify Leumi in respect of any sums due to it under the RFA.

Following Cobra's administration, Leumi took over the collection of Cobra's receivables on its sales ledger which were to be the essential source of repayment of the sums due to it under the RFA.

The Claim

The proceedings concerned a clause in the RFA which provided for a “collection fee” payable to Leumi by Cobra which was charged at a rate of up to 15% on all sums that were collected by Leumi (“**Collection Fee Clause**”).

The fee, if payable, fell within BHL's indemnity obligation under its indemnity agreement.

Leumi did in fact charge a collection fee at the full rate of 15% on the sums collected (which totalled approximately £8 million) and therefore amounted to approximately £1.2 million. Leumi subsequently made demand on BHL for the amount of £1.2 million. BHL did pay sums of £400,000 and £550,000 respectively in respect of the collection fee but later alleged that it had done so by a mistake of law.

In 2012, BHL issued a claim against Leumi alleging that Leumi was not entitled to charge a collection fee of 15%; and that £950,000 that BHL had already paid to Leumi had been paid by mistake of law, such that Leumi should now repay that sum to BHL.

The legal issues

TRUE CONSTRUCTION

The Court was required to consider the true construction of the Collection Fee Clause which read as follows:

“... Leumi will be entitled to charge the Client an additional collection fee at up to 15% of amounts collected by Leumi thereafter. ... The Client expressly acknowledges that such fee constitutes a fair and reasonable pre-estimate of Leumi's likely costs and expenses in providing such service to the Client”.

BHL argued that Leumi was entitled merely to its actual costs and expenses of collections, to be calculated after the collection process had ended and subject to a ceiling of 15% thereof.

The other alternatives to this interpretation were that Leumi could charge any fee it wished and without reference to any anticipated or actual costs, subject only to a maximum of 15% (the position advanced by Leumi). Alternatively, that Leumi had a discretion to charge a fee which was to be based on estimated or actual costs but which could go no higher than 15% of the receivables.

EXERCISE OF DISCRETION

If the court held that the true construction of the Collection Fee Clause was as per the latter of the three options, the Court was to decide whether a) Leumi had in fact exercised discretion in setting the collection fee and if so, b) had it done so lawfully.

PENALTY CLAUSE

Was the Collection Fee Clause a penalty, as argued by BHL?

Decision

TRUE CONSTRUCTION

His Honour Judge Waksman QC rejected BHL's argument that the Collection Fee Clause ought to be construed on the basis that Leumi was only entitled to charge its actual costs and expenses at the end of the collection process, subject only to a maximum of 15% of the sums collected. The detail of the Judge's findings were fact specific and naturally focussed on the wording of the Collection Fee Clause. He noted that if BHL's interpretation was correct then the last sentence of the clause (*The Client expressly acknowledges that such fee constitutes a fair and reasonable pre-estimate of Leumi's likely costs and expenses in providing such service to the Client*) would be meaningless.

However, the Judge also rejected Leumi's argument that the collection fee was not directed at its anticipated costs and expenses and that Leumi could charge any fee it wished without reference to either cost, subject only to a maximum of 15%. He described Leumi's interpretation of the clause as "*commercially absurd*", giving Leumi an "*untrammelled discretionary power*".

EXERCISE OF DISCRETION

Instead, the Judge found that:

1. Leumi had the right to charge a collection fee and exercise discretion when setting the percentage rate to apply to the sums collected based on estimated or actual costs, which could go no higher than 15%; and
2. the discretion to be applied by Leumi had to be qualified, otherwise such discretion could be exercised oppressively or abusively. Discretions such as this must be exercised "*in a way which is not arbitrary, capricious or irrational in the public law sense*". In particular, he referred to the recent Supreme Court decision in *Braganza v BP Shipping Limited* [2015] UKSC 17 which he subsequently referred to as the "*Braganza duty*" and said that: "*the*

fulfilment of that duty will entail a proper process for the decision in question including taking into account the material points not taking into account irrelevant considerations. It would also entail not reaching an outcome which was outside what any reasonable decision maker could decide, regardless of the process adopted. However, the duty does not mean that the Court can substitute what it thinks would have been a reasonable decision".

Here, the particular exercise of discretion was the process followed in estimating costs to arrive at a percentage rate. The aim should have been that Leumi was reimbursed with all of its costs and therefore the decision maker needed to identify the following:

1. The amount of the collectible receivables which needed to be recovered;
2. The estimated likely costs of that exercise;
3. Such costs as a percentage of the sums to be collected.

The Judge determined that Leumi had plainly decided to charge 15% but the real question was whether it had exercised any discretion (based on an estimation of costs) in arriving at the 15% rate. He concluded that there had been no real exercise of discretion.

Fundamental to this finding was Leumi's evidence which showed that its decision-maker at the bank, had always as a matter of practice charged the maximum where the provision gave a fee which could be "up to" a certain percentage.

HHJ Waksman QC went further and said that even if it were thought that there was an exercise of discretion (which he had expressly rejected here) the exercise of discretion was wholly defective because Leumi did not:

1. Attempt to calculate its likely costs and expenses based on experience of previous collections;
2. Consider the extent to which the collection process was likely to be materially carried out by third parties;
3. Consider whether a short delay in setting the charge would allow them to form a more informed view as to the proper percentage which ought to be applied; or
4. Attempt to undertake a process by which some sort of sensible estimate of costs could be reached perhaps with reference to how much it needed to raise in the collection process.

The Court went on to consider the counter-factual, that is to say what percentage would or could BHL have arrived at had it sought to apply the discretion in a lawful manner and in the manner HHJ Waksman outlined in the Judgment. As a starting point for estimating costs, the judge considered the amount of actual costs and expenses that Leumi had incurred. In determining the highest percentage fee that could have been charged without breaching the *Braganza duty*, he held that Leumi ought to have delayed setting the collection fee until the end of June when the perceived uncertainty in the amount of collections would have been much clearer to Leumi. He held that 4% was the maximum that it could have charged in exercising its lawful discretion.

PENALTY CLAUSE

HHJ Waksman QC also rejected the argument that the construction of the collection fee clause was the penalty and thus unenforceable. He did so by reference to the recent decision of the Supreme Court in *Makdessi v Cavendish Square Holdings BV* [2015] UK SC 67 he concluded that:

1. Cobra's obligation to pay a collection fee to Leumi was a primary, not a secondary obligation therefore was not akin to a sum payable instead of damages; and
2. Even if Cobra's payment obligation was secondary in the exercise of a discretion meant that it could not be a penalty (as to which, see below).

Comment

Whilst the Judge in this case accepted the limitation which had been set down in *Braganza* which is that it may not be appropriate to apply to contractual decision-makers the same high standards of decision making as are expected in a modern state, he also pointed out that this case concerned a large “*sophisticated organisation*” with considerable experience of performing collections. The key decision-maker had been involved in many collections over the course of his career and therefore must have had a “*considerable amount of data about how much collect outs [sic] can and do cost over a range of cases.*”

The decision is an important reminder that the courts are willing to scrutinise the exercise of discretionary powers in commercial agreements. Where fees are set according to the discretion (expressly stated or otherwise) of one party, then that party must be able to demonstrate a lawful exercise of the same. At the very least, it must be able to demonstrate that (where a party has the necessary expertise) charges have been properly considered in the relevant context and are not arbitrary amounts, failing to take into account relevant factors.

For further information on any of the issues raised in this legal briefing, please contact:

Alistair Graham

Partner, London

E: alistair.graham@mayerbrown.com

T: +44 20 3130 3800

Gemma Rochelle

Associate, London

E: grochelle@mayerbrown.com

T: +44 20 3130 3473

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