
Assessing the status of rent in corporate insolvencies – why the Lundy Granite principle may not be written in stone

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A tension has existed for over 150 years regarding the extent to which landlords must prove for rent in an insolvency and the extent to which rent can be classified as an expense. In the absence of effective statutory guidance, the courts have in modern times been forced to reassert principles whose origins lie in 19th-century case law. Such a situation is unsatisfactory, both because those principles do not stem from consistent judicial analysis and because the onus is on the courts to strain doctrine to generate sensible outcomes. The appropriate solution is clarification through statutory intervention.

INTRODUCTION

It is a usual feature of corporate insolvencies that the main creditors are likely to be the company's bank, the tax authorities and the company's landlord. Secured creditors enjoy a privileged position in any insolvency and the legislature is entirely capable of protecting its revenue-collecting institutions; however, in the UK at least, the relationship between the company and the landlord is based mainly on the concept that the landlord is indistinguishable from other unsecured creditors.

It must also be recognised that the insolvency landscape in the UK has altered considerably in the last 30 years – the role of the administrative receiver has dwindled and administration is now regarded as the preferred option for distressed companies. In turn, the relationship between the company and its landlord has altered fundamentally and it is seemingly for the courts to act as mediators of any novel consequences armed only with rather generic legislation. In this ferment, the *Lundy Granite* or the “salvage” principle has reassumed prominence in judicial thinking, despite the fact that it remained apparently moribund for much of the 20th century.

The principle was originally used by the courts as a way of determining whether or not they should exercise a discretion to allow a landlord to distrain in a liquidation. Since then it has become a method of classifying expenses, including the payment of rent, in an insolvency context.

The unresolved tension in this context is between the special rights of a landlord, eg to forfeit a lease or distrain for rent, and the inter-relationship between creditors as being *pari passu*. Therefore, to what extent should a landlord be entitled to exercise those rights to elevate its status and to what extent should it remain in the queue with the other unsecured creditors?

The purpose behind this analysis is to suggest that the current approach is simply inadequate; the role of leasehold property in a company's operations is fundamental. Being of such importance, it is somewhat inconceivable that the legislature has never taken any material steps to create a clear framework in which a landlord's special status can be managed.¹ In turn, it is also argued that the courts in the UK are disappointingly having to manipulate 19th-century judicial precedent derived from a context far removed from that of modern insolvency law to find a solution that should be provided by statute.²

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¹ A strong case can be made for saying that generally, in the context of insolvency in the UK, the landlord and tenant relationship has been singularly overlooked. See eg M Davey and D Milman, “Debtor Rehabilitation: Implications for the Landlord-Tenant Relationship” [1996] JBL 541, where this situation is described as a legislative “blind spot”.

² The current *Insolvency Rules 1896* (UK) (SI 1986/1925) are to be replaced from 6 April 2017 by a new set of Rules (SI 2016/1024). No material changes are proposed in respect of the new rules governing expenses of administration (r 3.50) and of winding-up (r 6.42).

CONTEXT

It is highly likely that most businesses will have to trade or operate from a physical site. Some may acquire the relevant freehold; however, many will not wish to commit to such a large capital outlay and will, instead, lease their premises. Others may have used a sale and leaseback of freehold premises as a way of freeing up capital. The lease commitment can be quite long, to meet both the landlord and the tenant's business needs. A common element of the relationship will be the tenant's obligation to pay rent in advance on each quarter day.³

A business in financial difficulties has to make difficult choices about the allocation of limited resources. The position regarding trade creditors can, perhaps, be managed to a certain degree. However, little or no flexibility exists when faced with the next rent payment. This situation may be exacerbated where a single tenant operates from multiple sites, eg retail tenants with a countrywide presence.⁴

A major tactical decision is the timing of any administration. Having already paid a quarter's rent in advance, the temptation is to wait until the last minute before taking the step into administration. The clear choices are, therefore, to enter administration on the day prior to the rent becoming due or on the day immediately after.

The moratorium administration creates effectively puts in stasis all the usual remedies that creditors of that company could normally exercise, including landlords' traditional remedies of forfeiture and distress – now commercial rent arrears recovery (CRAR)⁵ – requiring either the consent of the administrator or permission of the court. In turn, administrators are in a strong position from which to deflect claims by landlords.

Landlords find themselves subject to similar constraints in a liquidation. A landlord purporting to levy distress/CRAR in the context of a compulsory liquidation will need the leave of the court;⁶ in a voluntary winding up, such an action can be prevented by a successful application for a stay of proceedings by the liquidator.⁷

HISTORICAL PERSPECTIVE

A large body of Victorian case law is of significance in this area. As such, it is important to consider this in some detail, not least because it has been heavily relied upon in modern cases.

With the enactment of the *Limited Liability Act 1855* (UK) and the *Companies Act 1862* (UK), the limited liability company as understood today came into being. As part of this framework for limited liability companies, it was also necessary to legislate for their insolvency.⁸ Part IV of the 1862 Act contained those provisions governing winding up of companies. In particular, ss 87 and 163 were germane in the context of landlords exercising their rights against insolvent companies.

Section 87 stated:

³ Traditionally, quarter days are 25 March, 24 June, 29 September and 25 December. These dates would correspond to religious festivals within the yearly calendar, at which point it was customary for debts to be settled and disputes to be resolved. As the use of these quarter days is a consequence of custom, rather than a legislative obligation, it is not uncommon to find modern leases with alternative quarterly days that correspond with the calendar year, ie 1 January, 1 April, 1 July and 1 October.

⁴ A recent (and arguably notorious) example is British Home Stores, which, in anticipation of the March quarter date, called upon, inter alia, its landlords to accept the terms of a company voluntary arrangement, which would reduce its rental liabilities. (See eg C Warmoll, "KPMG Prepares CVA for Beleagured BHS Empire", *Accountancy Age*, 9 March 2016 <<http://www.accountancyage.com/aa/news/2450214/kpmg-prepares-cva-for-beleagured-bhs-empire>>). Despite this being agreed to, it was still insufficient to save the company.

⁵ See Ch 2, Pt 3 of the *Tribunal, Courts and Enforcement Act 2007* (UK). As much of the case law is concerned with distress, this anachronistic term is used throughout, and these cases are referred to as the "distress cases".

⁶ *Insolvency Act 1986* (UK) s 130(2).

⁷ *Insolvency Act 1986* (UK) ss 112(1), (2).

⁸ It is arguable that corporate insolvency law actually started with the introduction of the *Joint Stock Companies Act 1844* (UK) – see RM Goode, *Principles of Corporate Insolvency Law* (Sweet & Maxwell, 2nd ed, 1997) 7.

When an order has been made for winding up a company under this Act, no suit, action, or other proceeding shall be proceeded with or commenced against the company, except with the leave of the Court, and subject to such terms as the Court may impose.

Section 163 stated:

Where any company is being wound up by the Court or subject to the supervision of the Court, any attachment, sequestration, distress, or execution put in force against the estate or effects of the company after the commencement of the winding-up shall be void to all intents.

These seemingly contradictory stipulations were reconciled by Turner LJ in *In re Exhall Mining Company*,⁹ where it was explained that s 163 should be read as being subject to the exercise of the discretion contained in s 87. Despite subsequent doubt expressed on this analysis,¹⁰ no court challenged this conclusion, and so it became the orthodoxy that landlords should apply to court for leave to distrain against an insolvent tenant's goods. As a consequence, the primary consideration of most 19th-century cases was, as Lindley LJ explained in *In re Lancashire Cotton Spinning Company*:

... [to] see on what grounds a person who asks to be allowed to issue a distress or execution can escape from the peremptory provision contained in sect. 163.¹¹

Therefore, it is suggested that the focus of the courts in the late 19th century was purely one of statutory interpretation. Parliament had imposed a statutory impediment on creditors to enable effective and efficient winding-up. As Lindley LJ explained:

The object of the winding up provisions of the Companies Act, 1862, is to put all unsecured creditors upon an equality, and to pay them *pari passu*.¹²

Those words echo those of Fry J less than a year earlier, when he stated:

... the Court will administer the assets of a company among all the creditors at the time of winding up *pari passu*, and will, so far as is possible, not give any preference or priority between the various creditors.¹³

The challenge facing the courts was that a landlord's right of distress was incompatible with the concept of *pari passu*. Further, whilst trade creditors could effectively freeze their relationship with an insolvent company at the time of winding-up and prove in the liquidation for debts due and owing, without incurring further exposure, landlords were in a different position in that their undoubted right of forfeiture was perhaps more imagined than real, so companies could continue to benefit from their tenancies for the duration of the winding up. To compound the possible prejudice suffered by landlords, unlike modern rental practice, most rent was payable in arrears.

Clearly there was a commercial imperative on landlords to seek to improve their lot in a winding up, which may explain the frequency with which the issue was litigated in the latter half of the 19th century.¹⁴

The real question was, therefore: on the basis that a landlord was owed rent both in respect of occupation by the company before and after the winding up, to what extent was that sum provable and to what extent could it be recovered by distress? In turn, to allow distress would be to elevate the status of a landlord in comparison to other unsecured creditors. The only solution to this dilemma was the exercise of judicial discretion, as afforded by s 87 of the 1862 Act.

What is apparent from an analysis of the cases is that judicial attitudes developed in a piecemeal fashion; no overarching principle arose from the legislation that could be applied consistently from the

⁹ *In re The Exhall Coal Mining Company, Ltd* 4 DJ & S 377, 379.

¹⁰ See eg Bowen LJ in *In re Lancashire Cotton Spinning Company* [1887] 35 Ch D 656, 666.

¹¹ *In re Lancashire Cotton Spinning Company* [1887] 35 Ch D 656, 664.

¹² *In re Oak Pits Colliery Company* [1882] 21 Ch D 322, 329.

¹³ *In re Brown, Bayley & Dixon* [1880-81] LR 18 Ch D 649.

¹⁴ It should be noted that mortgagees also sought to exercise their right to distrain, so the cases are not limited to landlords (discussed below).

start. In turn, as the case law developed, so the courts had to reconcile differing previous approaches, Lindley LJ describing the pre-existing case law in 1887 as “numerous and not altogether consistent”.¹⁵

As such, the courts were constantly wrestling with the unresolved tension and using factual justifications for their decisions. For example, if the premises “were retained for the benefit of all parties” – ie the creditor company, the liquidator and the landlord – then distress was prevented.¹⁶ Similarly, where a liquidator did “nothing except abstain from trying to get rid of the property which the company holds as lessee”, this was also sufficient to displace any right to levy distress.¹⁷

Further, mortgagees, who had a mortgage by way of demise¹⁸ and who sought to exercise their right of distress under the consequent leasehold interest, were considered to have less entitlement than a landlord to exercise such a right by two decisions of the Court of Appeal.¹⁹ In the latter of these two cases, Lindley LJ explained the court’s reasoning as such:

The distinction between the two cases as all against the mortgagee – that is to say, it is easier for a landlord to shew why he should have leave than a mortgagee ... The ground of the distinction is obvious. It would be unjust to say that a company holding under a lease might go on in the hope of carrying on its business and then tell the landlord that it would not pay his rent ... The reason [to distrain] is not so cogent in the case of a mortgagee. The mortgagee has the benefit of his security; and if the liquidator enhances the value of that security, that is as much for the benefit of the mortgagee as of the company.²⁰

Again, the concept of mutual benefit is being used to displace any presumption in favour of a creditor. Only where a (landlord) creditor is to be prejudiced by the circumstances of the winding up will the court exercise its discretion. However, the dominant theme from these 19th-century cases is that the onus is on the landlord to convince the court to exercise its discretion:

... in order to get rid of the fetter imposed by s. 163, you must establish special circumstances – special circumstances must be shewn.²¹

Perhaps one of the clearest iterations of “special circumstances” can be found in the judgment of Cotton LJ in *In re Lancashire Cotton Spinning Company*, where he states:

In my opinion the landlord coming to ask the Court to exercise the power which according to the decisions has been given by sect. 87 must shew one of two things, either that it is inequitable for the company or its liquidator to insist on sect. 163 – that there is some special equity which entitles the landlord to ask the Court to relieve him of the burden of sect. 163 – or that it is a case in which the Court will allow distress to be put in so as to recover the rent which ought to be paid as one of the expenses of winding up. But the matter must be brought within one or the other of those heads in order to justify the Court in disregarding the express provisions of sect. 163, which in terms are clear.²²

IN RE LUNDY GRANITE COMPANY

So far, no specific discussion of *Lundy Granite*²³ has been entered into. This should not be seen as a serious omission – it is suggested that the necessary jurisprudence can be easily understood without reference to it. However, to demonstrate why this assertion can legitimately be made, it is first necessary to consider the case in some detail.

¹⁵ Lindley LJ in *In re Lancashire Cotton Spinning Company* [1887] 35 Ch D 656, 664.

¹⁶ Lord Romilly MR in *In re Progress Assurance Company* [1869-79] LR 9 Eq 370, 373.

¹⁷ Lindley LJ in *In re Oak Pits Colliery Company* [1882] 21 Ch D 322, 331.

¹⁸ Now no longer possible.

¹⁹ *In re Lancashire Cotton Spinning Company* [1887] 35 Ch D 656; *In re Higginshaw Mills and Spinning Company* [1896] 2 Ch 544.

²⁰ Lindley LJ in *In re Higginshaw Mills and Spinning Company* [1896] 2 Ch 544, 550.

²¹ Lopes LJ in *In re Higginshaw Mills and Spinning Company* [1896] 2 Ch 544, 551.

²² *In re Lancashire Cotton Spinning Company* [1887] 35 Ch D 656, 662.

²³ *In re Lundy Granite Company* [1870-71] LR 6 Ch App 462.

In August 1863, H granted M a lease of Lundy Island.²⁴ M, in turn, agreed to assign his lease to the Lundy Granite Company, although it appears from the reported facts that this assignment was never formally executed. The company operated a quarry on the east side of the island until November 1868, when an order to wind up the company was made. The liquidator, for possibly very practical reasons, left the company's property on the island, and rent was paid until June 1869. Whilst the facts of the case are not that clear from the report, the suggestion is that H continued to look to M for payment of the rent, under the rules of privity of contract. However, this having proved unsuccessful, H then sought to distrain against the goods of the company, which were present on the island. The issue for the court was whether or not s 163 of the *Companies Act* prevented this.

The matter was first heard by Romilly MR, who refused permission to distrain.²⁵ Of particular importance to the Master of the Rolls were two salient facts: first, the company was not actually a formal tenant of H; secondly, for that reason, the landlord could not formally prove in the company's liquidation. Effectively, H, as the landlord, was relying upon the ability to distrain against any goods left on the demised premises, irrespective of whether or not they belonged to the tenant.

Drawing a parallel with the situation where a tenant was an actual creditor of its landlord, Romilly MR asserted that "the Court would stop the distress, and allow the applicant to prove for the amount of rent against the company". This was based upon the following unequivocal assertion:

I am of the opinion that the whole of the principle of this Act, and the reasons for these sections, was not to prevent a person from recovering his proper debt against the company, or his proper claim against the company, but to put everybody who had claims upon the company upon an equal footing.²⁶

On the basis that the right of distress accorded H a status akin to a creditor, the Master of the Rolls refused to sanction the distress but ordered that H could prove in the liquidation of the company.

The internal logic of such an argument is attractive, but it must surely be regarded as too indulgent an exercise of judicial discretion. The discretion afforded by s 87 was to allow distress to proceed or not; in turn, a denial of such right could not be ameliorated by the fiction of creditor status. The dilemma facing the court was, however, apparent. The ambiguity in s 163 was whether or not it should be limited to actions initiated by creditors of a company. The peculiarity of distress was that, without creditor status, a landlord could still enforce its rights. A narrow reading of s 163 would allow landlords in similar situations the ability to disrupt massively the conduct of a winding up. Alternatively, to deny landlords the ability to distrain would be to change the law on distress.

What is seen, therefore, is a resort to judicial *legerdemain* in an effort to resolve the statutory lacuna. As shown below, this is still the case today.

The landlord succeeded on appeal; the Court of Appeal adopting a narrow reading of s 163. Mellish LJ concluded as follows:

It is a question of general importance whether this section relates only to distress against the company, that is to say, where the company is the debtor, or extends, as has been contended, to all cases of distress. The landlord is, by the law of this country, entitled to take as a security for his rent the goods upon his land, whomsoever they belong to. Then, was it intended to deprive the landlord of that right if the goods happened to belong to a company under liquidation.

It would be very extraordinary if the Legislature had deprived the landlord of that right without clear and express words ... The right to prove debts is confined to creditors of the company, and it is this section makes this distress void, I do not see what power the Court would have to say that the landlord has any right to prove for his debt ... The difficulty is not met by saying that the landlord can get leave to proceed under sect. 87, for that section is confined to proceedings against the company ... when we look at the place where sect. 163 comes in, it is seen clearly to deal with the rights of creditors under

²⁴ Lundy Island is a three mile long island off the coast of North Devon in the UK and is now a popular visitor attraction. Readers who are interested can find out more at <<http://www.landmarktrust.org.uk/lundyisland>>. In particular, this website contains some brief information as to how William Hudson Heaven came to buy Lundy in 1834 for £9,870.

²⁵ The entire judgment is set out as a footnote to the report of the Court of Appeal judgment.

²⁶ *In re Lundy Granite Company* [1870-71] LR 6 Ch App 462, fn 1. (The entire judgment of Romilly MR is set out as a footnote to the report of the Court of Appeal judgment).

the winding-up ... It was not the intention of the Legislature to deal at all with the rights of a landlord, who may be a total stranger to the company, and may not know to whom the goods belong.²⁷

In a similar vein James LJ concluded:

Now these words cannot be taken as meaning that the distress is to be absolutely void to all intents, or else the Court would have no jurisdiction to allow the landlord to proceed; and, moreover, a distress would be void as against another lessee if the goods of the company were left on the land and were taken. But it is impossible that a distress on land can be void merely because the company have goods there.

In no other part of the Act is any person dealt with except the company, its creditors, and its contributories. The sole object of the Act was to make an equitable provision in the nature of a bankruptcy for the distribution of the effects of the company amongst the persons entitled, but not to alter any other rights which they might acquire during the winding-up ... It must be the true meaning of the Act to consider these provisions as confined to proceedings by a creditor of the company against the goods of the company; and the Act must be read according to the manifest intention, which could not have been that during the many years over which the winding-up may extend the Court should have power to interfere with the rights of every one who happened to have goods of the company in his possession. The landlord has a right to proceed against his tenant, and against the goods of every stranger which happen to be upon the land, and subject to distress.²⁸

In other words, the landlord in this context had a right that had not been explicitly curtailed by Parliament, so the court was not minded to prevent the exercise of that right. Section 163 was limited in its effect to co-coordinating the relationship between creditors of the insolvent company; it did not extend to “strangers”, as the court described the landlord in this context.

Stepping back from the detail of the decision, however, what is evident is that the court was not concerned with formulating a principle of universal import; rather, it was struggling to reconcile a pre-existing right with a new legislative regime. The fundamental problem was that the right to distress was incompatible with the concept of *pari passu*. This tension was not resolved in the 1862 legislation nor has it since.

IS THE PRINCIPLE TRULY A PRINCIPLE?

Lundy Granite is, therefore, fact-specific and perhaps a little unusual in that the status of the occupying company was not that of creditor to the landlord. If the purported assignment to it had been correctly formalised, privity of estate would have created a legally recognised relationship between the landlord and the tenant.²⁹ Further, the landlord still had a right in contract against the original tenant, M. If such right had borne fruit, the issue of distress against the company would never have arisen. It is arguable, therefore, that, as authority, it is somewhat of an anomaly.

Further, it is arguable that what has arisen as “principle” stems from purely obiter comments made by James LJ. In considering the situation regarding a landlord and a tenant company, the following paragraph appears to have been seen as definitive:

But in some cases between the landlord and the company, if the company for its own purposes, and with a view to the realization of the property to better advantage, remains in possession of the estate, which the lessor is therefore not able to obtain possession of, common sense and ordinary justice require the Court to see that the landlord receives the full value of the property. He must have the same rights as any other creditor, and if the company choose to keep the estates for their own purposes, they ought to pay the full value to the landlord, as they ought to pay any other person for anything else, and the Court ought to take care that he receives it.³⁰

Aside from being obiter, it is suggested that two other aspects to this explanation mean that it should not be regarded as a definitive statement:

²⁷ *In re Lundy Granite Company* [1870-71] LR 6 Ch App 462, 467.

²⁸ *In re Lundy Granite Company* [1870-71] LR 6 Ch App 462, 466.

²⁹ This right no longer exists in a modern assignment context due to the effect of the *Landlord and Tenant (Covenants) Act 1995* (UK).

³⁰ *In re Lundy Granite Company* [1870-71] LR 6 Ch App 462, 466.

- 1) no authority is provided to substantiate such a conclusion; and
- 2) there seems no justification to import the concepts of “common sense and ordinary justice” into the statutory machinery.

This was later recognised by Cotton LJ in *Lancashire Cotton Spinning*, where he stated:

It is unfortunate, perhaps, that a good many of the cases on these two sections, and on applications like this, have not dealt with the matter as directly as they might have done. In one authority which has been referred to, *In re Lundy Granite Company*, the question really did not arise, and it was only *some general observations of Lord Justice James, which, with all respect, were not applicable to the case before him*, which are relied on as laying down what the doctrine is.³¹ [emphasis added]

The strength of feeling behind these words is not difficult to discern. If *Lundy Granite* had laid down such a strong principle, why was the Court of Appeal some 16 years later not according it due significance?

For much of the 20th century, reported case law on this matter is scarce. The next major case on the issue is *In re ABC Coupler & Engineering Co*,³² which was heard before Plowman J in early 1969. What is telling within Plowman J’s judgment is his conclusion that:

*In In re Higginshaw Mills and Spinning Co ... the Court of Appeal treated these two cases as containing all the relevant law.*³³

The two cases the judge was referring to were *In re Oak Pits Colliery*³⁴ and *Lancashire Cotton Spinning*, not *Lundy Granite*. Further, there is no mention in the judgment of the concept of the *Lundy Granite* or the salvage principle. There is also evidence that Plowman J did not feel totally constrained by pre-existing authority, in that he actively entertained the suggestion made in argument that the issue of whether or not property is retained for the benefit of a winding up is a question of a liquidator’s motivation.³⁵ Ultimately, however, Plowman J acknowledged that he had to “look at the matter from a broad commonsense point of view”.³⁶

Two relevant cases followed, both first instance, in the mid 1970s. In the first of these, *In re Downer Enterprises Ltd*,³⁷ Pennycuik VC explained that in reaching his decision he was “applying well established principles”,³⁸ although he did take issue with the introduction of the concept of “motivation” in *ABC Coupler*.

In the second of these cases, *HH Realisations*,³⁹ Templeman J’s analysis was very much focused on the *ABC Coupler* case as the (then) modern summation of the position. In the final analysis, however, he came to a conclusion that he believed was “fair and reasonable”.

It is difficult, therefore, to achieve a sense of the application of a well-defined doctrine as the touchstone against which a decision should be reached. What the above analysis demonstrates is that the response of the courts was mainly about what “seemed right” in the circumstances.

HOW DID LUNDY GRANITE ASSUME ITS PROMINENCE?

Despite the continued absence of any statutory clarification in this regard, by the mid-1970s there was a canon of case law, which, although not definitive, could provide guidance by analogy in the context

³¹ *In re Lancashire Cotton Spinning Company* [1887] 35 Ch D 656, 662.

³² *In re ABC Coupler & Engineering Co Ltd (No 3)* [1970] 1 WLR 702. It is fascinating that all of the cases referred to in the judgment were heard in the 19th century, which suggests that a commercial or pragmatic approach was perhaps found by liquidators that displaced the need for judicial intervention in the intervening years, although no specific evidence has been found to substantiate this assumption.

³³ *In re ABC Coupler & Engineering Co Ltd (No 3)* [1970] 1 WLR 702, 712.

³⁴ *In re Oak Pits Colliery Company* [1882] 21 Ch D 322.

³⁵ *In re ABC Coupler & Engineering Co Ltd (No 3)* [1970] 1 WLR 702, 721.

³⁶ *In re ABC Coupler & Engineering Co Ltd (No 3)* [1970] 1 WLR 702, 721.

³⁷ *In re Downer Enterprises Ltd* [1974] 1 WLR 1460.

³⁸ *In re Downer Enterprises Ltd* [1974] 1 WLR 1460, 1467.

³⁹ *Re HH Realisations Ltd* [1976] 31 P & CR 249.

of a liquidation. However, it must be recognised that the landscape of insolvency was changed fundamentally by the introduction of administration as a formal insolvency procedure in the *Insolvency Act*. In turn, similar issues to those that had troubled 19th-century judges when liquidation was put on a statutory footing re-emerged in the late 20th century, in particular the status of expenditure incurred during administration. It is unsurprising, therefore, that parallels were drawn between the two procedures and the distress cases discussed assumed a new prominence.

The decision of the Court of Appeal in *In Re Atlantic Computer Systems*⁴⁰ is arguably the first explicit formulation of the “liquidation expenses” principle. Nicholls LJ, delivering the judgment of the court, conducted a thorough analysis of the distress cases, which featured in argument at first instance. In doing so, he was led to draw an important distinction between a landlord seeking the right to forfeit and seeking leave to distrain. Nicholls LJ explained that in the former case “leave is given as of course”; however, in the latter case:

... to grant leave would be inconsistent with the purpose for which Parliament imposed the prohibition on proceedings.⁴¹

His Lordship, however, qualified this conclusion thus:

... the matter stands differently if the debt ... was a new debt incurred by the liquidator for the purposes of the liquidation. In such a case the grant of leave would not be inconsistent with the purpose of the legislation.⁴²

Further, he stated:

It is important to keep in mind that this principle, relating to outgoing on property retained by a liquidator for the purposes of the winding up is no more than a principle applied by the court when exercising its discretion ... The principle, which it will be convenient to call the “liquidation expenses” principle, is a statement of how ... the court will exercise its discretion ...⁴³

The Court of Appeal was prepared to acknowledge that much of this principle was equally relevant to administrations, subject to one significant qualification, which Nicholls LJ explained as follows:

In liquidations the principles on which the court will exercise its discretion have hardened into a set practice, both in relation to “possession” cases and in the application of the “liquidation expenses” principle. In “possession” cases leave is granted as of course, and in the circumstances in which the “liquidation expenses” principle is applicable, entitlement to have the outgoing paid as an expense of the liquidation seems to have become *more or less automatic*. In our view there is no place for comparable hard-and-fast principles in the case of administrations. The reason for this difference is that the objectives of winding up orders and administration orders are different and, hence, the approach that should be adopted by the court when exercising its discretion under the two regimes is different.⁴⁴ [emphasis added]

So, taking this analysis at face value, the outcome of the liquidation expenses principle was, according to his Lordship, a given – the discretion afforded by statute was in name only, as the result would usually be the same. By contrast, the discretion reserved for the courts in administrations was subject to no such fetters.

The significance of *Atlantic Computers* was that there was now apparently a recognised principle, endorsed by the Court of Appeal, which had to be applied in the context of liquidation expenses; although one should note the somewhat cautionary tones of Nicholls LJ when he described the principle as “no more than a principle applied by the court when exercising its discretion”.⁴⁵ Whilst such an attempt to reconcile previous authorities was necessary, was there actually sufficient

⁴⁰ *In Re Atlantic Computer Systems PLC* [1992] Ch 505.

⁴¹ *In Re Atlantic Computer Systems PLC* [1992] Ch 505, 521.

⁴² *In Re Atlantic Computer Systems PLC* [1992] Ch 505, 522.

⁴³ *In Re Atlantic Computer Systems PLC* [1992] Ch 505, 523.

⁴⁴ *In Re Atlantic Computer Systems PLC* [1992] Ch 505, 527.

⁴⁵ *In Re Atlantic Computer Systems PLC* [1992] Ch 505, 523.

consistency in previous judicial reasoning to permit such a hard and fast conclusion? Furthermore, by specifically acknowledging such a principle, the Court of Appeal was, in turn, obliged to deny its formal application in the context of an administration.

It is perhaps for this reason that the House of Lords in *Re Toshoku Finance*⁴⁶ attempted to reformulate the position; although, as demonstrated below, the effect of this case was, somewhat ironically, to create a further erroneous orthodoxy.

The case concerned the status of corporation tax liabilities of a company in liquidation. The liquidators sought directions on whether they were payable as expenses thereof or whether the tax authorities would have to prove in the liquidation for their debt. At first instance the court held them not to be an expense; this decision was reversed by the Court of Appeal. The liquidators appealed unsuccessfully to the House of Lords.

Lord Hoffmann, delivering the leading judgment, was faced with an interesting argument put forward by counsel for the liquidators in an effort to exclude the liability as an expense, which he explained thus:

... Mr Phillips put forward a more radical argument. He said that the terms of r 4.218(1) did not in themselves determine whether a liability counted as an expense of the liquidation. The rule was made, as I have said, under a power to make provision as to the expenses which “may be treated as the expenses of a winding up”. Mr Phillips laid stress upon the word “may”. He said that the rule created only an outer envelope within which expenses were contained. If they could not be brought within one of the paragraphs of the rule, they could not count as expenses. But the reverse was not necessarily true. In order to be treated as liquidation expenses, they also had to pass a judge-made test which Nicholls LJ in *Re Atlantic Computer Systems plc* ... called the “liquidation expenses” principle. That principle was one of fairness. If a liability was incurred as a result of a step taken for the benefit of the insolvent estate, it was fair that the burden should be borne by the persons for whose benefit the estate was being administered. So Mr Phillips said that a liability falling within r. 4.218(1) was payable as an expense only if it arose as a result of a step taken with a view to, or for the purposes of, obtaining a benefit for the estate.⁴⁷

In a rebuttal to this suggestion, Lord Hoffmann provided his own analysis of the development of the liquidation expenses principle. His conclusion was that the principle had no role in determining what constituted an expense of the liquidation; that was entirely a matter of statutory interpretation:

... the question of whether such liabilities should be imposed upon companies in liquidation is a legislative decision which will depend upon the particular liability in question. It should not be ruled out by an illegitimate extension of the liquidation expenses principle, which was devised more than a century ago for a different purpose.⁴⁸

The problem facing his Lordship was simple. Through an exercise of statutory discretion the courts had effectively elevated the status of landlords in corporate insolvencies. As such, the discretion had been conflated with the entitlement. As Lord Hoffmann had already pointed out:

... it was obvious to everyone that there could be no practical difference between allowing a landlord to levy a distress for rent falling due after the winding up and directing the liquidator that he should be paid in full.⁴⁹

As Nicholls LJ had breathed new life into this concept in *Atlantic Computers*, it was only natural that interested parties would seek to regard the liquidation expenses principle as influential in determining creditors’ entitlements. Quite correctly, Lord Hoffmann wanted to demonstrate that this was a legal fallacy. However, and with the greatest of respect to his Lordship, it is suggested that several elements of Lord Hoffmann’s analysis have only continued to generate confusion in this area.

First, simply by giving such attention to the concept and by repeated reference to the *Lundy Granite* principle as a formal principle gave it a life of its own, which, it is believed, should not have

⁴⁶ *Re Toshoku Finance (UK) plc* [2002] BCC 110.

⁴⁷ *Re Toshoku Finance (UK) plc* [2002] BCC 110, 114.

⁴⁸ *Re Toshoku Finance (UK) plc* [2002] BCC 110, 121.

⁴⁹ *Re Toshoku Finance (UK) plc* [2002] BCC 110, 117.

been accorded to it.⁵⁰ It is suggested that it would have been preferable to deny its status as a formal principle and to affirm it as the exercise of a statutory discretion only. In particular, Lord Hoffmann referred to *Lundy Granite* as “influential” when, as discussed above, subsequent Court of Appeal decisions did not accord it such status.

Secondly, and with respect to his Lordship, the fallacy about the precedent value of *Lundy Granite* was perpetuated thus:

In the *Lundy Granite Co* case ... the court was therefore exercising the discretion conferred by s. 87 of the 1862 Act to decide that, contrary to the normal *pari passu* rule, a creditor who had a debt which was capable of proof at the date of liquidation should be paid in priority to other creditors.⁵¹

As explained, the landlord creditor had no such status to prove in the liquidation of the company.

Further, and more substantially, Lord Hoffmann left open the door to allow the principle to continue to be a rule of interpretation when he explained that:

The court will of course interpret r. 4.218 to include debts which, under the *Lundy Granite Co* Principle, are deemed to be expenses of the liquidation. Ordinarily this means that debts such as rents under a lease will be treated as coming within para (a), but *the principle may possibly enlarge the scope of other paragraphs as well.*⁵² [emphasis added]

His Lordship stressed that the application of the principle “does not involve an exercise of discretion”;⁵³ however, if the principle allows liabilities to be deemed to be expenses, the exercise of judicial discretion must be implicit.

Thirdly, it is suggested that it would have been a simple matter to limit the principle to the issue of recoverability of rent, thus dispensing with counsel’s argument at a stroke. A parallel can be drawn with the issue of rates. Having considered some of the relevant cases, in particular the Court of Appeal’s rejection of the liquidation expenses principle in *Re National Arms and Ammunition Co*,⁵⁴ Lord Hoffmann concluded:

It therefore did not follow that because a liquidator might in certain circumstances retain possession of leased property without having to pay rent as an expense of the liquidation, he did not in the same circumstances have to pay the rates.⁵⁵

What can be seen from this distinction is that, even in the 19th century, the courts were already alive to the fact that the principle was not of universal application. Why not state so here? It involves no violence of logic to ring-fence the principle to issues of distress in an insolvent situation. In fact, it is arguable that this is what the Court of Appeal in *Atlantic Computers* was (partially) attempting to do by excluding the principle from the context of administration.

In defence of his Lordship’s approach, there are several statements within Lord Hoffmann’s judgment that are relatively unequivocal, most notably his assertion that the *Lundy Granite* principle “was not, however, a general test for deciding what counted as an expense of the liquidation”⁵⁶ and that “the discretion is as to the remedy which the creditor should be allowed to exercise”.⁵⁷ However, even here, there is scope for misunderstanding. Lord Hoffmann asserted that a claim must be classed as a liquidation expense before the court is entitled to exercise a discretion as to which remedy is available to the relevant creditor. However, this appears to contradict two previous assertions made by his Lordship: the first being that the *Lundy Granite* principle is relevant in determining the ambit of

⁵⁰ Of a 47 paragraph judgment, 28 are devoted to discussion of this issue.

⁵¹ *Re Toshoku Finance (UK) plc* [2002] BCC 110, 117.

⁵² *Re Toshoku Finance (UK) plc* [2002] BCC 110, 119.

⁵³ *Re Toshoku Finance (UK) plc* [2002] BCC 110, 119.

⁵⁴ *In Re National Arms and Ammunition Co* [1885] 28 Ch D 474.

⁵⁵ *Re Toshoku Finance (UK) plc* [2002] BCC 110, 118.

⁵⁶ *Re Toshoku Finance (UK) plc* [2002] BCC 110, 118.

⁵⁷ *Re Toshoku Finance (UK) plc* [2002] BCC 110, 120.

r 4.218; the second that there could be no practical difference between allowing a landlord to levy distress and directing the liquidator to pay the landlord in full.

The changing of the “polarity” of the principle into one relating to remedy rather than entitlement is, it is submitted, difficult to reconcile with the authorities. It is difficult to imagine that judges in the 19th century ever considered themselves to be simply exercising a discretion to grant a remedy; the consequence of allowing distress in these circumstances was obvious.

The somewhat paradoxical nature of Lord Hoffmann’s judgment can be seen in its analysis in *In re Portsmouth City Football Club Ltd*,⁵⁸ a case where solicitors’ fees, as opposed to rent, were claimed to be payable as an expense of an administration. *Toshoku Finance* was put forward by counsel for the solicitors as grounds for treating the fees in question as expenses. The court was, therefore, being asked to enlarge the scope of r 2.67, a possibility alluded to by Lord Hoffmann. In rebutting this argument, Morgan J was sensitive to the difficulties arising from *Toshoku*, explaining that:

Taken literally, the references to expenses being “treated” as liquidation expenses, or the list of such expenses being “enlarged”, might suggest that it is open to the court to hold that certain matters can be liquidation expenses even when they do not fit within the lists of such expenses. I do not consider that Lord Hoffmann had such a possibility in mind.⁵⁹

The issue was resolved accordingly by the judge:

If the company is under a liability to pay a sum under the Lundy Granite principle, then it seems to me that, as a matter of fact, payment of such a sum will be a necessary disbursement within rule 4.218(3)(m). In that way, paragraph (m) is “enlarged” by the Lundy Granite principle ... Paragraph (a) of rule 4.218(3) refers to expenses “incurred” by the office holder. Technically, because the contract in question, such as a pre-liquidation lease, was entered into by the company before the commencement of the liquidation, the liability was incurred by the company when it entered into the lease and the liability was not incurred by the liquidator. However, as explained in *In re Oak Pits Colliery* ... as regards the liability to pay under the contract after the benefit of the contract is retained for the purposes of the winding up, the position is to be “regarded” in just the same way as if the contract had been entered into by the office holder for the purposes of the liquidation. In that way, the liability is to be “treated” as a liability incurred by the office holder. Similarly, the court will “interpret” the word “incurred” as extending to a case where the action of the liquidator, in retaining the benefit of the contract for the purposes of the liquidation, has resulted in a liability to pay in full the sums due under the contract.

If *In re Toshoku Finance UK plc* [2002] 1 WLR 671 is understood in this way, then the Lundy Granite principle does not involve a qualification of the conclusion that the list of expenses in rule 4.218 is indeed an exhaustive list.⁶⁰

This is an elegant solution to the dilemma posed. However, it is arguable that, by assimilating the principle within the actual statutory terminology, this renders the salvage principle irrelevant, which seems to contradict the assertion made by Lord Hoffmann.

THE CURRENT APPLICATION OF THE LUNDY GRANITE PRINCIPLE

As explained, the formulation of the liquidation expenses principle in *Atlantic Computers* and its subsequent forensic analysis in *Toshoku Finance* highlighted a perceived doctrine, which, it is believed, should not have the status it does and should not be regarded as having universal application. However, the continued growth of the principle is first demonstrated by the case of *Goldacre (Offices) Ltd v Nortel Networks*.⁶¹

The issue at stake was simple – the landlords sought an order that rent falling due under various leases should be payable as an expense of the administration. It was, therefore, open to the court,

⁵⁸ *In re Portsmouth City Football Club Ltd (in liq)* [2013] Bus LR 374.

⁵⁹ *In re Portsmouth City Football Club Ltd (in liq)* [2013] Bus LR 374, 400.

⁶⁰ *In re Portsmouth City Football Club Ltd (in liq)* [2013] Bus LR 374, 401.

⁶¹ *Goldacre (Offices) Ltd v Nortel Networks UK Ltd (in administration)* [2010] Ch 455.

taking a cue from *Toshoku Finance*, to regard this as nothing more than an exercise in interpreting r 2.67(1) of the *Insolvency Rules 1986* (UK). However, the court held that there were sufficient parallels between this and r 4.218(1)(a), as considered in *Toshoku Finance*, to subject them to the same interpretative process. As such, Judge Purle QC, sitting as a High Court judge, regarded *Lundy Granite* as having a determinative effect in administrations. Perhaps the most telling aspect of Judge Purle QC's judgment is where he explains:

I do not accept the reasons ... advanced for not regarding rent as an administration expense in the present case. The *Lundy Granite* principle seems, in my judgment, clearly to apply, and the court's jurisdiction to order payment derives from the relevant rules which, *properly construed in accordance with the Lundy Granite principle*, compel payment ...⁶² [emphasis added]

As such, the learned judge's "inclination would be to regard rent as falling within rule 2.67(1)(a)" – ie as an expense properly incurred by the administrator in performing his functions.

The consequential conundrum is whether or not *Lundy Granite* is merely an aid to interpretation or a fundamental rule of construction. Either way, it would appear that the absolutism of Lord Hoffmann's warning against treating it as a general test of classification was somewhat difficult to adhere to.

An arguably stricter approach was taken in the Scottish case of *Cheshire West and Chester Borough Council*.⁶³ The case concerned the occupation of premises for 11 months rent-free by an administrator. The landlords sought an order that the outstanding rent should be paid as an expense of the administration. Lord Menzies summarised the issue facing him thus:

I now turn to consider the question whether the court has a discretion in deciding whether rent for the premises between May and November 2008 is an expense of the administration, or whether this is a mandatory obligation to be determined by the rules. Although I am attracted by the flexible approach adopted by the Court of Appeal in *Atlantic Computer Systems*, which may well be in accordance with the original concept of a "rescue culture" underlying the introduction of the administration procedure, in light of the decision of the House of Lords in *Toshoku* and the changes to the rules I do not consider that the court has any discretion in deciding what is or is not an expense of the administration. *This falls to be decided by applying the Lundy Granite principle, as explained in Toshoku*.⁶⁴ [emphasis added]

Lord Menzies concluded:

... that the matter is now to be considered exclusively by reference to the rules and that if the rental liability falls within the rules, then that is payable as a matter of mandatory obligation, not as a matter of discretion, either on the part of the administrator or on the part of the court.⁶⁵

Without further analysis or apparent application of the principle, his Lordship was therefore prepared to treat the rent in question as an expense of the administration. Clearly this demonstrates no exercise of discretion, but equally it is difficult to see from the judgment just why such a conclusion was reached.

In both this case and *Goldacre*, the *Lundy Granite* principle has been given prominence by the court, but it is difficult to extract from either of these cases any clear application of doctrine. Upon what basis are the rules to be interpreted and to what extent was *Lundy Granite* influential?

Further evidence of the difficulties facing the courts can be seen in *In re Luminar Lava Ignite Ltd*.⁶⁶ Whilst the primary issue was again that of the status of rent during an administration, one material factor should not be overlooked. The companies in question went into administration shortly after the September quarter rent was payable. The administrators asserted that rent which fell to be payable prior to the commencement could not be considered an expense of the administration. Success in this regard would clearly grant administrators a powerful trump card in the exercise of their duties by timing the start of an administration accordingly.

⁶² *Goldacre (Offices) Ltd v Nortel Networks UK Ltd (in administration)* [2010] Ch 455, 462.

⁶³ *Cheshire West and Chester Borough Council* [2011] BCC 174.

⁶⁴ *Cheshire West and Chester Borough Council* [2011] BCC 174, 187.

⁶⁵ *Cheshire West and Chester Borough Council* [2011] BCC 174, 187.

⁶⁶ *In re Luminar Lava Ignite Ltd* [2014] Ch 165.

Judge Pelling QC, sitting as a High Court judge, explained that:

The outcome of the issue I am now considering depends upon the applicability ... of the principle referred to in the authorities variously as the “Lundy Granite” ... or “salvage” principle.⁶⁷

How is this statement to be treated in light of *Toshoku Finance*? On the one hand, it would appear that this is not the approach envisaged by Lord Hoffmann; on the other, if pre-existing debts can be “deemed” to be expenses, then is it not the case that such questions can only be decided by reference to *Lundy Granite*, in which case an element of judicial discretion will always be present?

With only the bare bones of the statutory regime as guidance, it is not surprising that counsel for both sides and, consequently, the judge were driven to seek guidance from the distress cases, in particular the cases of *In re Oak Pits Colliery*⁶⁸ and *In re Silkstone and Dodworth Coal and Iron Co.*⁶⁹ This should not be seen as remarkable; particular issues of the timing of liquidation were prominent in these cases and much turned upon them.

In summary, therefore, Judge Pelling QC concluded:

Thus *In re Silkstone and Dodworth Coal and Iron Co* 17 Ch D 158 is of application only in relation to rent that accrues due after the commencement of the winding up or administration and after the office holder has elected to retain possession for the purpose of the liquidation or administration. It is of no application where, as here, the rent in question accrued before the commencement of the administration. Apportionment has no role to play in relation to rent payable in advance for reasons that I have already identified. Thus that part of the rent that fell due prior to the commencement of the administration that is attributable to the period after the administrators had elected to retain the properties for the purposes of the administration is not recoverable as an administration expense. This approach is consistent with the reasoning in *In re Silkstone and Dodworth Coal and Iron Co* because the obligation to pay the rent in issue did not arise during a period when the office holder was retaining the property for the purposes of the administration but arose prior to that date.⁷⁰

On the basis of his analysis of the authorities, Judge Pelling QC offered the following summation:

- (i) Rent accruing prior to the commencement of the relevant insolvency procedure did not have the status of a recognised expense, even if it meant that the administrator effectively benefitted from a rent free period.
- (ii) Rent accruing after the commencement of the relevant insolvency procedure should be treated as a recognised expense and be payable in full even if the administrator vacated the premises prior to the expiration of that rental period.⁷¹

These conclusions are no longer good law, as explained below; however, irrespective of the relative merits or otherwise of this decision, what is manifest is the challenge facing the courts in resolving these issues in a consistent way. Once it is acknowledged that *Lundy Granite* has some role to play in administrations, then arguably the totality of the jurisprudence surrounding the distress cases must be imported into this context, hence their prominence in *Luminar Lava*. However, is this not effectively an extension of the principle that Lord Hoffmann warned against in *Toshoku Finance*?

Both *Goldacre* and *Luminar Lava* caused disquiet both for landlords and insolvency practitioners,⁷² so it is no surprise that both cases were overruled in the subsequent Court of Appeal decision of *Jervis v Pillar Denton Ltd.*⁷³ For the purposes of this discussion, however, what is more significant is that *Pillar Denton* can now be considered the modern touchstone for the salvage principle, the Court of Appeal enthusiastically endorsing its relevance.

⁶⁷ *In re Luminar Lava Ignite Ltd* [2014] Ch 165, 173.

⁶⁸ *In re Oak Pits Colliery Company* [1882] 21 Ch D 322.

⁶⁹ *In re Silkstone and Dodworth Coal and Iron Co* [1881] 17 Ch D 158.

⁷⁰ *In re Luminar Lava Ignite Ltd* [2014] Ch 165, 177.

⁷¹ *In re Luminar Lava Ignite Ltd* [2014] Ch 165, 178.

⁷² For a contemporary critique of these cases, see Mr Justice Morgan, “Rent as a Liquidation Expense or an Administration Expense” (2013) 26(5) *Insolv Int* 72.

⁷³ *Jervis v Pillar Denton Ltd* [2015] Ch 87.

First, on the issue of the salvage principle being a rule of statutory interpretation, Lewison LJ, delivering the only judgment of the court, confirmed that it is applicable to the interpretation of r 2.67 of the *Insolvency Rules*.⁷⁴ Secondly, Lewison LJ asserted that “whether the salvage principle applies is not a matter of discretion”.⁷⁵

In addressing his own self-imposed question as to the nature of the salvage principle, Lewison LJ acknowledged that it was a “judge-made deeming provision”. That much is obvious. More significantly, he also expressed the view that:

although the salvage principle owes its origins to applications relating to distress for rent, it has long outgrown those origins.⁷⁶

As such, it was entirely capable “of being applied to factual situations that did not confront our Victorian forebears”.⁷⁷ Thus there would appear to be an explicit acknowledgement of the far-reaching effect of the principle beyond the confines of rent in a liquidation context.

Lundy Granite as an authority itself was also accorded high status, Lewison LJ stating that:

It is this case [*Lundy Granite*] which gave one of its names to the principle; and must in my judgment be taken to be an authoritative exposition of what it entails.⁷⁸

It has already been asserted that *In re Oak Pits Colliery* should be considered superior authority to *Lundy Granite*. However, his Lordship was of a different opinion, expressing a view that the judgment of James LJ “has at least equal status with Lindley LJ’s rationalisation of it”.⁷⁹

Lewison LJ concluded:

The true extent of the principle, in my judgment, is that the office holder must make payments at the rate of the rent for the duration of any period during which he retains possession of the demised property for the benefit of the winding up or administration (as the case may be). The rent will be treated as accruing from day to day. Those payments are payable as expenses of the winding up or administration. The duration of the period is a question of fact and is not determined merely by reference to which rent days occur before, during or after that period. This, in my judgment, is the way that James LJ formulated the underlying principle in *In re Lundy Granite Co* LR 6 Ch App 462 itself.⁸⁰

It is suggested that this could be described as a very generous interpretation of *Lundy Granite*. It is difficult to imagine that the court had such issues in its mind at the time. Further, can such a conclusion be seen as merely the application of a rule of interpretation? It is arguable that such an approach has elevated the status of the salvage principle beyond a deeming provision to one that has allowed the court to create a set of rules to deal with the situation before it.

What is telling is the “quasi-equitable” approach taken by the court. Lewison LJ asserted that:

It may not be a maxim of equity, but in simple terms: you can’t have the penny and the bun. Equally, I cannot see that common sense or ordinary justice requires a landlord to be paid rent in full for a period after the office holder has vacated the premises, leaving the landlord free to relet them.⁸¹

In the final analysis, therefore, it may be that the two rather protean concepts of “common sense” and “ordinary justice”, which provide the courts with considerable latitude in their approach, are the real determining factors.

⁷⁴ *Jervis v Pillar Denton Ltd* [2015] Ch 87, 96.

⁷⁵ *Jervis v Pillar Denton Ltd* [2015] Ch 87, 113. It is arguable that this is a somewhat expansive interpretation of what Lord Hoffmann stated in *Toshoku Finance*; instead, his Lordship explained that “the application of the principle does not involve an exercise of discretion”: *Re Toshoku Finance (UK) plc* [2002] BCC 110, 119.

⁷⁶ *Jervis v Pillar Denton Ltd* [2015] Ch 87, 114.

⁷⁷ *Jervis v Pillar Denton Ltd* [2015] Ch 87, 114.

⁷⁸ *Jervis v Pillar Denton Ltd* [2015] Ch 87, 100.

⁷⁹ *Jervis v Pillar Denton Ltd* [2015] Ch 87, 115. With the greatest of respect to the learned judge, it is suggested that, in light of earlier discussion and especially the view expressed by Cotton LJ in *Lancashire Cotton Spinning*, it is difficult to be quite so unequivocal about the status of the case.

⁸⁰ *Jervis v Pillar Denton Ltd* [2015] Ch 87, 120.

⁸¹ *Jervis v Pillar Denton Ltd* [2015] Ch 87, 115.

In many ways, and somewhat paradoxically, it is *Pillar Denton* that is the high watermark of the salvage principle, not the 19th-century distress cases. The difficulties faced by the courts in confirming the status of rent in administration has led them enthusiastically to assert the principle as a central tenet of the issue.

Looking at these recent cases in the round, it is difficult to see any true consistency in the courts' approaches.⁸² Of course, it is arguable that a sensible compromise has finally been reached in the context of administrations, but is it true to say that this is as a result of the application of coherent and well-defined doctrine? More fundamentally, is this the correct way in which a modern insolvency regime should operate to allocate risk and liability?

In this context, a bold assertion is made. The decision in *Luminar Lava* was actually, as far as it could be, a correct application of existing doctrine, despite the potentially unpalatable consequences for both landlords and administrators. This would not be the first time where a court has had to reach a difficult decision. However, there are commercial realities the legislation does not formally address and, it is suggested, *Luminar Lava* tries to resolve these logically.

First, rent payable in advance, which becomes due and payable before an administrator is appointed, cannot be a liability imposed on the administrator ex post facto. As the law stands, if a tenant is unable to meet its rental obligations, it is not for the administrator to plug this gap. In the 19th-century distress cases, where distress was permitted it was not done so on the basis of the attribution to the liquidator of a specific pre-existing contractual obligation.

Secondly, if rent is payable in advance and arises during an administration, then this is a legitimate expense of the administration and, as with the corporate tenant itself, there is always a risk that "full value" of such a payment may not be achieved by occupation for the full three months. Such issues did not trouble judges in the 19th century for two main reasons:

- (i) Rent, usually payable in arrears, could be apportioned by statutory intervention in the form of the *Apportionment Act 1870* (UK). A fact that was agreed by all parties in *Luminar Lava*.
- (ii) Claims for distress were usually retrospective and, therefore, quantified financially.⁸³

By contrast, it is submitted that the decision in *Pillar Denton* involved a rather "expansive" reinterpretation of pre-existing doctrine or principles. The Court of Appeal strained every sinew to reach a decision that created a more sensible regime, but the main justification for its conclusions would appear to be simply "fairness". In explaining the defect in the reasoning in *Luminar Lava*, Lewison LJ explained that:

... Judge Pelling QC lost sight of the fact that the salvage principle is founded in equity and not on the common law. How the common law would view an instalment of rent payable in advance is not determinative of how equity would treat it.⁸⁴

It is difficult to find any equitable thread in the distress cases. However, if this assertion is regarded as incorrect, it is indicative of the defective state of the law that equitable principles are being grafted onto a primarily statutory construct to bring about "justice".

A further complication is whether or not it can be assumed that the situation is equally true of liquidations or are the previous decisions reached by the courts in that context entirely untouched by *Pillar Denton*? In any event, this state of affairs will only last as long as *Pillar Denton* remains good authority. This is a rather insubstantial foundation for an important tenet of insolvency law.

⁸² It is interesting to note that, after analysing the three cases from the 20th century – namely *ABC Coupler*, *Downer Enterprises* and *HH Realisations* – Lewison LJ was forced to conclude that they "do not present an entirely consistent picture": *Jervis v Pillar Denton Ltd* [2015] Ch 87, 103.

⁸³ A partial exception to this can be found in *Shackell & Co v Chorlton & Sons* [1895] 1 Ch 378 where a lease term allowed the landlord discretion to demand two quarters' rent in advance. The company having gone into liquidation, the landlord activated this right. Kekewich J, conscious that the liquidator may not remain in possession for the next two quarters, held that the liquidator had to confirm a date to give up possession and, accordingly, should pay rent to the landlord up to that date, which the report indicates did, in fact, happen.

⁸⁴ *Jervis v Pillar Denton Ltd* [2015] Ch 87, 120.

THE AUSTRALIAN PERSPECTIVE

Unsurprisingly, the issue of classification of liquidation expenses is not confined to the UK. The approach of the courts in Australia is also instructive.

The main statutory provision is s 556 of the *Corporations Act 2001* (Cth),⁸⁵ which sets out in some detail the order of priorities for payment of expenses on the liquidation of a company. Warren J in *Ansett Australia Ground Staff Superannuation Plan v Ansett Australia Ltd* explained that "... paragraphs (a) and (dd) [of s 556]⁸⁶ reflect the English provisions in wording and in their content".⁸⁷ For this reason, arguments were heard before the court focusing on the respective influence of many of the cases already referred to in this analysis, what the judgment referred to as the "rent cases".⁸⁸

The administrators involved put forward an analysis of these cases, with which Warren J agreed, and which were summarised as follows:

First, prima facie claims under pre-liquidation leases are provable; they are not payable as expenses of the winding-up, the importance of preserving *pari passu* distribution being emphasised. Second, although rent is not incurred by the liquidator (the obligation existing in the pre-liquidation lease) the ambit of the administration expense is expanded where the liquidator actively retains (as opposed to passively holds) or uses the premises for the purposes of the winding-up. In those circumstances rent accruing during that period of retention or use will be an expense of the winding-up. Third, the rent will not be an expense of the winding up where the retention or use is agreed to or acquiesced in by the landlord so as to secure mutual benefits for both the purposes of the winding-up and the landlord.

It would appear therefore that the Australian courts have been prepared to embrace a strict categorisation of the pre-existing authorities and, importantly, to acknowledge expressly an exception based on the purpose behind the insolvency practitioner's retention of the property; a concept which has already been explained as a device by the Victorian courts of England and Wales to limit the ambit of their discretion.

Several years later, the Federal Court of Australia was called upon specifically to decide the status of rent payments in a liquidation in *Timbercorp Securities Ltd v Plantation Land Ltd*.⁸⁹ Again, the court found UK authorities to be instructive. The learned judge, Finkelstein J, appeared to be influenced, in particular, by the idea promulgated in *ABC Coupler* that an "election" by a liquidator to retain possession of the land in question was determinative. In turn, Finkelstein J acknowledged that:

Whether or not the liquidator has elected to retain possession ... may involve a subjective assessment of the state of mind of the liquidator but, more usually, will be determined objectively based on what the liquidator has said and done ...⁹⁰

Applying this test, the learned judge decided that no such election had been made, so the rent in question was only provable in the liquidation.

Interestingly, what this case shows is that the determination of the status of rent payments involved a judicial discretion – it is not simply a question of classification by application of statute. In turn, there is the inescapable consequence that a court must conduct a forensic analysis of the specific

⁸⁵ Section 556(1) of the *Corporations Act 2001* (Cth) has been described as the "closest Australian statutory equivalent to r. 4.218(1) of the *Insolvency Rule 1986*": *Australian Securities and Investments v Letten (No 13)* (2011) 86 ACSR 174 [54] (Gordon J).

⁸⁶ The relevant paragraphs state the following: "(1) Subject to this Division, in the winding up of a company the following debts and claims must be paid in priority to all other unsecured debts and claims: (a) first, expenses (except deferred expenses) properly incurred by a relevant authority in preserving, realising or getting in property of the company, or in carrying on the company's business; ... (dd) next, any other expenses (except deferred expenses) properly incurred by a relevant authority."

⁸⁷ *Ansett Australia Ground Staff Superannuation Plan v Ansett Australia Ltd* (2002) 174 FLR 1 [267].

⁸⁸ The case actually centred upon the status of pension entitlements, not rent payments.

⁸⁹ *Timbercorp Securities Ltd v Plantation Land Ltd* (2009) 72 ACSR 620.

⁹⁰ *Timbercorp Securities Ltd v Plantation Land Ltd* (2009) 72 ACSR 620 [19].

behaviour of the relevant insolvency practitioner. This is amply demonstrated by the subsequent case of *Grapecorp Management Pty Ltd v Grape Exchange Management Euston Pty Ltd*.⁹¹ Again, applying the liquidation expenses principle, Sifris J asserted that:

The fact that the liquidator retains possession of the land is not, of itself, sufficient to render the rent an expense of the winding-up. The possession must be *for the benefit of the winding up*.⁹² [emphasis added]

In turn, the learned judge was of the opinion that:

A resolution of the question of whether pre-liquidation expenses are covered by s. 556(1)(a) involves a necessary consideration of what was done, why or pursuant to what agreement (if any) and for whose benefit the work was done. In this regard, the conduct of the liquidators, evidenced by what they said and did, is of critical importance.⁹³

This approach required, in turn, an extensive evidential review of the actions and behaviours of the relevant company and insolvency practitioner. This should be contrasted with the view expressed by Pennycuik VC in *Downer Enterprises Ltd* that:

... I am not entirely happy at the expression “motivation”. That seems to make the right of the landlord dependent upon the subjective processes in the mind of the liquidator.⁹⁴

However, aside from the matter of which approach is correct jurisprudentially, the Australian courts do seem to have chosen to focus on the motivation behind the liability incurred as a significant determining factor. This, of course, was not a criterion which featured in Lord Hoffmann’s judgment in *Toshoku Finance*.

The position in liquidation must be contrasted with that of voluntary administration, where the effect of s 443B of the *Corporations Act* is to impose explicitly liability on an administrator for rental payments, subject to an indemnity from the company. This provision presumably reflects the differing nature of administration from liquidation and its impact on the status of the company, particularly the imposition of a moratorium.⁹⁵

What is instructive in this regard is the ability of the administrator to opt-out of this obligation by giving notice to the relevant creditor that the company does not propose to exercise rights in relation to the property in question.⁹⁶ It could be argued that this is the mirror image to the approach taken in winding up: in the latter, the liquidator’s intentions are, in the main, determinative; in the former, the administrator is deemed (by implication) to have the intention to use the property unless that is rebutted by formal notice.

However, for the purposes of this discussion, the point is made to illustrate the fact that the Australian legislature has taken a more interventionist role on this issue than in the UK, at least in the context of administration, leaving little room for doubt as to where liability must lie. Although it is arguable that, without legislative clarification, the Australian courts face the same difficulties as the UK courts when dealing with rent liabilities in a winding up.⁹⁷

⁹¹ *Grapecorp Management Pty Ltd v Grape Exchange Management Euston Pty Ltd* (2012) 265 FLR 33.

⁹² *Grapecorp Management Pty Ltd v Grape Exchange Management Euston Pty Ltd* (2012) 265 FLR 33 [83].

⁹³ *Grapecorp Management Pty Ltd v Grape Exchange Management Euston Pty Ltd* (2012) 265 FLR 33 [90].

⁹⁴ *In re Downer Enterprises Ltd* [1974] 1 WLR 1460, 1466.

⁹⁵ See ALRC Report No 45, [88] (the “Harmer Report”), which explains the rationale for its introduction.

⁹⁶ Liability only commences once five business days have elapsed (s 443B(2)(a)). Within this time period, the administrator has the ability to give notice to the relevant property owner that the company does not intend to exercise any rights in respect of the property (s 443B(3)). Any such notice displaces the obligation. This would appear to allow the administrator a window within which to make an assessment of the appropriate business needs of the company.

⁹⁷ Wellard makes the point that the influence of the *Lundy Granite* principle over the jurisprudence has led to inconsistencies in statutory interpretation. His suggestion is that the idea of “incurring” a debt in whatever circumstances is really a matter of causation, which can, in turn, achieve the same result as the *Lundy Granite* principle (described by Wellard as “somewhat

CONCLUSION

It has been demonstrated that the salvage principle, as understood, is actually a relatively modern, judge-made concept. Far from having hardened into a fixed principle, as some of the cases assert, it is entirely malleable in character. The courts in the 21st century have adopted it as a rule of apparently fair allocation of liability, whereas the courts in the 19th century were grappling with their ability to exercise a statutory discretion.

It is suggested that the primary causes of this are the attempt by the Court of Appeal in *Atlantic Computers* to synthesise pre-existing judgments into a coherent whole and the inadvertent reinvigoration of this principle by Lord Hoffmann's extensive analysis in *Toshoku Finance*, which has been subjected to subsequent reinterpretation by the courts. An impossible attempt was made in *Toshoku Finance* both to assert the dominance of the statutory rules and to preserve the existence and impact of pre-existing authority. This, in turn, has led to an unsatisfactory dichotomy where rent is in certain circumstances being treated "as if" it were an expense incurred for the purposes of an insolvency, when the wording of the relevant rules does not allow for such an approach.

It is suggested that a further confusion that has crept into this area is the idea that the *Lundy Granite* principle can be validated as a product of equity. Again, Lord Hoffmann's judgment in *Toshoku* needs to be considered. As part of his analysis, his Lordship asserted that, although the principle has its origins in a statutory discretion, it metamorphosed into an equitable principle.⁹⁸ This leap of logic is hard to understand; further, it is submitted, it is hard to justify. It is submitted that only in very rare circumstances should equity seek to intercede on matters of statute. If one considers Nicholls LJ analysis in *Atlantic Computers*, his view was that:

Over the years the courts have been concerned to establish the principles on which the discretion to give or refuse leave under that provision should be exercised. In doing so they have been guided, as one would expect, *by the purpose for which Parliament imposed the prohibition.*⁹⁹ [emphasis added]

It is submitted, therefore, that the issue is entirely one founded in statute. The focus of all the early cases is that of statutory interpretation and application. Issues of "fairness" and "reasonableness" may, therefore, be relevant, but they are unsatisfactory as an objective touchstone by which expenses should be judged.

The reasons for this state of affairs are, however, clear. Judges are looking to the principle to assist in determining the issue of how rent should be treated in an insolvency. The salvage principle is simply a convenient peg for the courts to hang their reasoning on. The absence of statutory guidance has meant that this principle has been inflated in importance to provide doctrinal justification for what are, in fact, value judgments of fairness and common sense.

Perhaps the sentiment of the courts is best summarised by Vaughan Williams J in *In re New Oriental Bank Corporation* where he stated:

[I]f a company which is in liquidation remains in beneficial occupation of a lease – that is to say, if it occupies the demised premises, or takes the rent, and thus obtains the benefit of the lease – the court *ought to do its very best to make the company pay the rent in full*, and not merely a dividend.¹⁰⁰ [emphasis added]

That statement was made over 100 years ago. Aside from whether it is constitutionally palatable for the judiciary to determine the rights of landlords, it is unfortunate that the UK courts are still having to strain logic to generate solutions to what is a complex issue, whose best solution lies in

nebulous"). It is suggested that this supports the view that the issue should be one of pure statutory interpretation, free from the baggage of historical doctrines. See M Wellard, "Debts 'Incurred' by Receivers, Administrators and Liquidators: The Case for a Harmonised Construction of ss 419, 443A and 556(1)(a) of the Corporations Act" (2013) 21 *Insolv LJ* 60.

⁹⁸ *Re Toshoku Finance (UK) plc* [2002] BCC 110, 118.

⁹⁹ *In Re Atlantic Computer Systems PLC* [1992] Ch 505, 520.

¹⁰⁰ *In re New Oriental Bank Corporation (No 2)* [1895] 1 Ch 753, 757.

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statutory intervention. Modern insolvency law is highly regulated and primarily the product of statute and regulation. To allow such a lacuna to continue is, it is submitted, a failing of the UK legislature.¹⁰¹

¹⁰¹ It is suggested that one of the problems is the accepted practice in the UK of the payment of rent three months in advance. One bold legislative step, therefore, would be to render automatically rent payable one month in advance in the context of an administration, which would ameliorate the problems associated with *Luminar Lava*. The *Apportionment Act 1870* (UK) addressed the perceived difficulties with rent payable in arrears. Why should not Parliament address the modern consequences of rent payable in advance?