Administration Expenses—Lundy Granite principle (Re London Bridge Entertainment Partners LLP (in administration))

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Restructuring & Insolvency analysis: Insolvency and Companies Court (ICC) Judge Barber held that the Lundy Granite principle does not extend to an obligation to 'top up' a rent deposit fund, where sums had been withdrawn from the fund to pay rent. Re London Bridge Entertainment Partners shows how seemingly immaterial business decisions made when an entity is solvent will be thrown into relief when the same entity becomes insolvent. Here, the decision to 'pay first, ask questions later' from the deposit fund meant that the landlord effectively lost its priority ranking in respect of those rent payments; a priority it could otherwise have been entitled to. The case also demonstrates that the ambit of provable debts will continue to be construed broadly, while the category of administration expenses will be narrowly construed. Written by Samuel Parsons, barrister at Guildhall Chambers.

Re London Bridge Entertainment Partners LLP (in administration) [2019] EWHC 2932 (Ch), [2019] All ER (D) 96 (Nov)

What are the practical implications of this case?

This case demonstrates the care that must be exercised when a commercial counterparty cannot pay. It was common ground that, if the rent for the period of the administrators' beneficial retention had remained unpaid, it would have been an expense of the administration [18]. The creditor landlord could therefore have been granted a significant priority in the administration in respect of those sums. But by drawing on the deposit to pay for the rent instalment, the landlord closed this avenue off.

ICC Judge Barber was unimpressed with the argument that this would give rise to 'unfairness' or engage the equitable *Lundy Granite* ((1871) 6 Ch App 462) principle. She determined that the landlord's decision to draw on the deposit was made consciously and freely. Perhaps of more concern to practitioners, she also observed (at [166]) that:

> 'if that election was the result of bad advice… the landlord's remedy is to bring a claim… for damages for professional negligence.'

That comment presupposes that the ambit of the *Lundy Granite* principle was clear from the outset. In the author's view, it seems at least arguable that the deposit could have been considered part of the bundle of rights and obligations associated with the requirement to pay rent. As a consequence, it is difficult to see how a potential professional negligence action for the landlord could provide a full solution. Nevertheless, *London Bridge Entertainment Partners* shows the care that practitioners will need to exercise when advising on issues of priority going forward. In doing so, the case reinforces the general principle of equality between unsecured creditors.

What was the background?

The dispute centred on the lease for the London Pavillion on Piccadilly, which previously housed a museum known as 'Ripley's Believe it or Not!'. The respondents to the application were the lessors of the property (the 'landlord'). There were essentially two agreements entered into between the company and the landlord:

- the lease itself, which included basic rent of £1,750,000 per annum, payable quarterly in advance
- the rent deposit deed (the 'deed'), under which the company paid the sum of £2,056,250 (the 'deposit') into a designated deposit account

The deed broadly provided that, if the tenant company failed to meet its rent obligations, the landlord could resort to the deposit to make up the rent then owing. Clause 5 of the deed provided for a 'top

up' obligation, by which the company was required to replenish the deposit if the landlord had drawn on the account to make up the unpaid rent.

Administrators were appointed on 29 September 2017. The company failed to pay a rent instalment on 1 October 2017. The landlord made a withdrawal from the deposit in respect of that rent on or around 9 October 2017. The company failed to replenish the deposit.

Having already drawn on the deposit, the question arose as to whether the 'top up' obligation could be accorded priority status in the administration, or whether the landlord would be restricted to proving for that debt and ranking alongside the other unsecured creditors.

What did the court decide?

After an impressive and thorough review of the authorities, ICC Judge Barber concluded that the *Lundy Granite* principle could not be extended to cover this situation. Two key principles arise:

- the general starting position is that all pre-insolvency creditors must prove for their debts, unless there is a basis for giving that creditor priority. Post-insolvency debts are generally payable (ie as expenses), rather than provable
- the *Lundy Granite* principle bridges these two categories. It allows, on equitable grounds, liabilities incurred pre-administration to benefit from priority where property has been retained by the administrator for the benefit of the estate: see *Re Toshoku Finance* [2002] UKHL 6 at [29]

Rent payments are the most obvious application of the *Lundy Granite* principle. It was common ground that the principle extends beyond rent. The principle could not, however, be extended to the 'top up' obligation because:

- the rent had already been paid (and in full). The administrators could not pay it twice: [152]
- it was not enough just that the liability *accrued* during the administrators' retention of the property; the liability must be incurred as a result of an act which will be for the benefit of the estate. This was just a 'happenstance of timing': [155]
- in all the circumstances, there was no basis for equity to intervene and displace the normal rules of priority in the administration: [156]. It would contravene the pari passu rule to give priority to the 'top up' obligation ([164]), and there was nothing unfair in that result, as it had resulted from a commercial decision: [166]

Case details

- Court: High Court, Chancery Division
- Judge: Judge Barber
- Date of judgment: 12 November 2019

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