



# Court of Appeal rules on the scope of the 'anti-deprivation' rule

In a much anticipated judgment the Court of Appeal has clarified the position regarding the anti-deprivation rule. It has held that it will only operate to avoid a transfer of assets from a company if the transfer is triggered by the company's insolvency. If the transfer occurs before the insolvency of the company, it cannot fall foul of the anti-deprivation rule.

The anti-deprivation rule has historically operated to invalidate a contract that has the effect of transferring a person's property to another (and thus removing it from the estate) on insolvency, contrary to the *pari passu* principle of distribution.

Many cases have followed the seminal decision of the House of Lords in *British Eagle*<sup>1</sup> in 1975, and as a result many contractual provisions have fallen foul of this decision, meaning that contracting out of the *pari passu* principle of distribution was contrary to public policy. Current market conditions have meant that the courts are again being asked to consider this issue.

The decision of the Court of Appeal<sup>2</sup> was the result of conjoined appeals deriving from the administrations of the estates of Lehman Brothers Special Financing and two of the Woolworths group companies.

## Facts

A detailed analysis of the facts of the Perpetual structured finance transaction is outside the scope of this briefing. However, it is worth noting that the documentation governing the issues in question had one particularly significant clause. This stated that the order of priority of distribution of the proceeds of realisation of collateral changed following an event of default under the swap agreement if the defaulting party was the

swap counterparty. Before an event of default the swap counterparty would rank first in order of priority, and after the event of default, it would be the noteholders.

The Butters appeal concerned a joint venture set up between a Woolworths entity and the BBC, and a licence under which the BBC granted the joint venture a licence to produce videos and DVDs of television programmes. The joint venture agreement provided that, if either party to the joint venture suffered an insolvency event, notice could be served on it requiring it to sell its shares to the other party at market value. The terms of the licence provided that it would terminate if a shareholder (or its parent) suffered an insolvency event, and notice was served requiring the sale of shares.

## The appeal decision

In relation to the Perpetual appeal, the Master of the Rolls, Lord Neuberger, held that the 'flip' from swap counterparty priority to noteholder priority did not constitute a deprivation which was precluded by the anti-deprivation rule. The effect of the flip provision was not to deprive the swap counterparty to the benefit of the noteholders, nor to deprive the swap counterparty of the benefit of the security rights granted to it. The flip was merely to change the order of priorities in which the rights were to be exercised in relation to the proceeds of sale of the collateral in the event of a default. The priority enjoyed by the swap counterparty was contingent on there being no event of default. The Master of the Rolls was persuaded by the fact that the noteholders' money

<sup>1</sup> *British Eagle International Airlines Ltd v Cie Nationale Air France* [1975] 1 WLR 758

<sup>2</sup> *Perpetual Trustee Company Limited & another v BNY Corporate Trustee Services Limited & another and Butters & others v BBC Worldwide & others* [2009] EWCA Civ 1160

had been used to purchase the collateral, and by the fact that a charge or provision for priorities for repayment had features similar to a lease or license and thus differed from ownership.

Even if the flip had constituted a deprivation, the rule would not in any event have been applicable as the triggering event was a Chapter 11 filing of a different entity which occurred before the Chapter 11 filing of the swap counterparty. Timing is everything.

There was nothing in the relevant clauses of either the joint venture agreement or the licence in the Butters appeal that triggered the anti-deprivation rule. It is common ground that a licensor may terminate a licence on the insolvency of a licensee without offending the anti-deprivation rule, much like a landlord's right to forfeit a lease. The fact that the right of termination was only exercisable in conjunction with the acquisition of the shares did not transform it into an unenforceable contract.

An option to acquire shares is not objectionable on the grounds of public policy unless the sale was at an undervalue, as a sale at full value does not offend the *pari passu* principle. The transfer of shares was required to be made for 'fair value' (which was defined as market value at the date of the notice) which ensured that the shares were not transferred at an undervalue. There was therefore nothing in the joint venture agreement or licence, whether construed separately or together, which fell foul of the anti-deprivation rule. In common with *Perpetual*, the rule would not have applied in any event because the notice trigger was the administration of an entity higher up in the group structure.

## Commentary

There have been other recent cases where the courts have been wary to overturn the intentions of the parties, as expressed in their written contract (please refer to Freshfields Bruckhaus Deringer's recent client briefing entitled *Sigma Finance case overruled – a return to pari passu?* for further details). The Master of the Rolls confirmed this approach: 'there is a particularly strong case for party autonomy in cases of complex financial instruments such as those involved in the *Perpetual* appeal and in arrangements involving large corporate groups, such as those who signed the agreements in the

Butters appeal; in such cases, the parties are likely to have been commercially sophisticated and expertly advised.'

The Court of Appeal was very mindful that Parliament has expressly considered the kind of transactions that fall foul of the anti-avoidance provisions of the insolvency legislation (such as transactions at an undervalue and preferences), and Longmore J in particular felt that it would not be appropriate for the Court to seek to widen the scope of those provisions by expanding the scope of a common law rule. Care should be taken not to treat the anti-deprivation rule as if it has its own existence and operation outside the provisions of the Insolvency Act which it is designed to protect. The court has the power to set aside any transactions disposing of property before the onset of insolvency. Per Longmore J, 'If the rule continues to exist, it can have no wider scope than the statutory provisions it is designed to enforce... the rule... does not entitle the court to set aside contracts between subsidiaries not in liquidation or administration and third parties merely because they may have some economic effect on the value of the holding company'.

The Court of Appeal seems therefore to have limited the scope of the anti-deprivation rule, such that it could be avoided by a well-structured transaction with carefully drafted documentation.

A decision on appeal is awaited.

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