

The anti-deprivation rule preventing the automatic disposal of assets on insolvency is not absolute

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According to long established principle, an agreement that an individual's property should transfer to someone else upon his insolvency, thereby depriving his creditors from receiving the benefit of those assets, is void. This is known as the "Anti-deprivation rule".

The Supreme Court in its judgement in *Belmont Park Investments PTY Limited (Respondent) v BNY Corporate Trustee Services Limited and Lehman Brothers Special Financing Inc [2011] UKSC 38* has recently confirmed this principle but introduced a radical modification to it.

Some of the key points from the judgment are as follows:

- The anti-deprivation rule is too well established to be discarded but the application of the principle has its limits.
- A deliberate intention to evade insolvency laws is required for the rule to apply. Rather as in "preference" cases, intention is now therefore an important factor. Commercial sense and the absence of intention to evade insolvency laws are also highly relevant. A genuine commercial transaction made in good faith, which does not have as one of its main purposes the removal of property from an individual's assets upon its liquidation, administration or bankruptcy, should not therefore be invalidated.
- The anti-deprivation principle does not apply if the deprivation takes place for reasons other than a party's administration, liquidation or bankruptcy, and not if it happens before formal insolvency.
- The source of the assets to be transferred on insolvency is also relevant. If the source of the assets is the person to whom they are to go to on insolvency, that could be an important factor in concluding that the transaction was a commercial one entered into in good faith (and therefore outside the scope of the anti-deprivation rule).

The case concerned the validity of security arrangements in

a complex series of credit swap agreements. The central issue in the proceedings was whether Lehman Brothers Special Financing Inc ("LBSF") or various investors ("the Noteholders") had priority over money that the Noteholders had invested in certain investments ("the Collateral"). Under the swap agreements, LBSF had priority over the Collateral but if LBSF was responsible for an event of default, which included the institution of bankruptcy proceedings against it, the Noteholders would have priority. LBSF became bankrupt in 2008 and the question was whether the provisions altering the priority over the Collateral in the Noteholders' favour upon LBSF's bankruptcy were effective.

LBSF argued that the provisions altering priority to the Collateral unlawfully deprived it of property that it would have been entitled to in its bankruptcy because they purported to change the priority LBSF enjoyed over the Collateral upon LBSF's bankruptcy. However, like the High Court and the Court of Appeal before it, the Supreme Court found in the Noteholders' favour: the provisions altering the priority to the Collateral from LBSF to the Noteholders did not offend the anti deprivation principle and were effective.

Parties considering entering into arrangements which may involve the transfer of assets from a party in financial difficulty should bear these points in mind. It could be difficult to determine whether parties had a "deliberate intention" to evade insolvency laws and the key to the application of the principle is likely to be the nature of the contract. If the contract is a complex one, such as the one in this case, where the deprivation is an unexpected by-product, then the principle may not apply. However, if the deprivation is a key element of the contract, particularly if the agreement takes place in contemplation of a possible insolvency, then the principle may well apply. To avoid the principle coming into play altogether, parties should provide for and ensure that any "deprivation" occurs prior to and not consequent upon administration, liquidation or bankruptcy.

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The decision could also affect whether the “football creditors” rule in football club insolvencies, where payments are made to “football creditors” in priority to other unsecured creditors, is allowed to continue. The case between HMRC and the Premier League over the validity of the “football creditors” rule is yet to be decided but comments made by the Justices in the LBSF case suggest the future may be bleak for the rule in its current guise. They made it clear that parties cannot contract out of the pari passu rule, which is the rule that, subject to certain preferential payments, all debts are to be paid equally. Potentially the anti-deprivation rule could also apply to the rule that transfers players registrations from their club to the Football League on the club’s insolvency.

For more information on this subject please contact:



David Hall
Partner

david.hall@burges-salmon.com
+44 (0)117 902 2798



Patrick Cook
Partner

patrick.cook@burges-salmon.com
+44 (0)117 307 6807