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Perpetual litigation comes to an end

On 27 July, the Supreme Court handed down its long awaited judgment in the case *Belmont Park Investments PTY Limited -v- BNY Corporate Trustee Services Limited and Lehman Brothers Special Financing Inc (LBSF).* Although there were no surprises – the decision essentially follows the Court of Appeal's view that "flip provisions" reversing a counterparty's priority in the payment waterfall are not contrary to the anti-deprivation principle, and did not deprive LBSF's insolvent estate of an asset – it does, however, provide some much needed clarity for those operating in the financial markets on the limits of the anti-deprivation principle.

Key Issues

- **Supreme Court upholds Court of Appeal Decision**
- **Flip provisions do not offend the anti-privation principle**
- **Good faith and commercial arrangements – unaffected**
- **Anti-deprivation has its place – but limited application**

Since November 2009, the effectiveness of flip provisions affecting swap counterparties in securitisation transactions has been called into question. However, the decision of the Supreme Court in this case would seem to have now laid these uncertainties to rest. The common sense approach taken by the Court in interpreting these complex financial arrangements and concluding that flip provisions do withstand insolvency and are not void for contravening the anti-deprivation principle is good news for both noteholders in securitisation transactions, and also those operating in the financial markets more generally.

Philip Hertz, partner in the restructuring and insolvency group remarks: *"The Supreme Court judgment provides much needed clarity. It sets out definite boundaries providing that the anti-deprivation principle should not be extended to bona fide commercial transactions where parties have organised their affairs with no intention of short-changing the other creditors in the event of an insolvency. For those involved in the financial markets the decision marks a further step towards legal certainty so that they can be confident that what they had originally bargained will not fall foul of a principle that dates back to, and perhaps is best left in, the 18th century".*

The leading judgment was provided by Lord Collins, who whilst reluctant to discard the anti-deprivation principle altogether, identified the following limits to the rule:

- A deliberate intention to evade the insolvency laws is required so as not to catch ordinary commercial transactions carried out in good faith; and
- The anti-deprivation principle does not apply if the trigger is an event other than the insolvency.

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In addition, Lord Collins identified the following as key issues to be considered when analysing the scope of the anti-deprivation principle:

- The distinction between an interest which is determinable on insolvency (otherwise known as a flawed asset) and an interest that determines on insolvency by a condition subsequent is too well established to be dislodged except by legislation. However, this does not mean that every interest expressed to determine or change on insolvency is valid; and

- The source of the asset is an important factor in the determination of whether the principle applies, but does not form a general exception to the principle.

Whilst Lord Collins' judgment focuses on the fact that the rule does not apply to commercial transactions carried out in good faith, the other reasoned judgment provided by Lord Mance centred on the fact that in his view LBSF was not deprived of any property in the first place. Further, Lord Mance considered that even if it could be argued that LBSF had been so deprived, the provisions of the flip clause were merely a contractual termination of future reciprocal obligations of the parties. In this case LBSF's recourse to the collateral was only available for as long as it was able to perform its side of the bargain. The limitation on the duration and operation of LBSF's interest was therefore prudent and it did not offend the principle.

The judgment is good news for those in the financial markets. It provides further testament to the English courts desire to give effect to contractual arrangements especially in cases which involve complex financial arrangements.

A more detailed analysis on the case is currently being prepared and will be circulated shortly.

(For more details on the factual scenario and earlier decisions see our briefings "Anti-deprivation and Financial Transactions: Inferno doused but smouldering" and "Noteholders assert priority over Lehman's jewels as the Dante programme proves to be an inferno of insolvency issues")