The Anti-deprivation Rule and the Pari Passu Rule in Insolvency

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In 2011 the UK Supreme Court delivered a judgment in Belmont Park Investments Pty v BNY Corporate Trustee Services Ltd that addressed the common law anti-deprivation rule. The anti-deprivation rule is a rule that is aimed at attempts to withdraw an asset on bankruptcy, with the effect that the bankrupt's estate is reduced in value to the detriment of creditors. The underlying public policy is that parties should not be able to contract to defeat the insolvency laws. The Supreme Court in Belmont recognised, for the first time, that there are two distinct rules arising from that public policy, the anti-deprivation rule and the pari passu rule. The latter rule provides that parties cannot contract out of the statutory provisions for pari passu distribution in bankruptcy. The Supreme Court's judgment has been applied in a number of cases in the UK. This article examines Belmont and its application in two subsequent cases.

0There is a general principle of public policy that parties cannot contract out of the legislation governing insolvency. From this general principle two sub-rules have emerged: the anti-deprivation rule and the rule that it is contrary to public policy to contract out of pari passu distribution (the pari passu rule). The anti-deprivation rule is a rule of the common law that is aimed at attempts to withdraw an asset on bankruptcy, with the effect that the bankrupt's estate is reduced in value to the detriment of creditors. The pari passu rule provides that parties cannot contract out of the statutory provisions for pari passu distribution,[1] reflecting the principle that the parties cannot contract to exclude the statutory provisions for pro rata distribution in bankruptcy, such that one creditor obtains more than its proper share. Pre-bankruptcy contractual subordination by a creditor is nonetheless enforceable on bankruptcy.[2]

1The principle of public policy that parties cannot contract out of the legislation governing insolvency goes back to the 18th century, with Lord Eldon LC credited as providing the starting point.[3] The courts did not use the term "deprivation" in this context until *Money Markets International Stockbrokers Ltd v London Stock Exchange Ltd*, in which Neuberger J, as he was then, referred for the first time to the "anti-deprivation principle".[4] The foundational cases for the rules occurred principally in the latter 19th century and early 20th century.[5] Those cases are discussed at length in *Money Markets International Stockbrokers Ltd*[6] and by the Court of Appeal in its judgment in the *Belmont*

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[1] Note that the statutory provisions for distribution of the bankrupt estate contain statutory exceptions to pari passu distribution, such as (in company liquidation) priority for the payment of the liquidator's fees and the payment of preferential claims. However, subject to those exceptions, the principle of pari passu distribution underpins the insolvency legislation. In this article references to pari passu distribution are references to the statutory rules of distribution.

[2] *Companies Act 1993* (NZ) s 313(3).

[3] *Higinbotham v Holme* (1812) 19 Ves Jun 88; 34 ER 451 and *Wilson v Greenwood* (1818) 1 Sw 471.

[4] *Money Markets International Stockbrokers Ltd v London Stock Exchange Ltd* [2002] 1 WLR 1150; as noted by Lord Collins in *Belmont Park Investments Pty Ltd v BNY Corporate Trustee Services Ltd* [2012] 1 AC 383; [2012] UKSC 38, [2].

[5] *Whitmore v Mason* (1861) 70 ER 1031; 2 J&H 204; *Re Jeavons; Ex parte Mackay* (1873) LR 8 Ch App 643; *Re Thompson; Ex parte Williams* (1877) 7 Ch D 138; *Re Harrison; Ex parte Jay* (1880) 14 Ch D 19; *Re Garrud; Ex parte Newitt* (1880) 16 Ch D 522; *Re Walker; Ex parte Black* (1884) 26 Ch D 510; *Detmold v Detmold* (1889) 40 Ch D 585; *Borland's Trustee v Steel Brothers & Co Ltd* [1901] 1 Ch 279; and *Worrell v Johns* [1928] 1 Ch 737.

[6] *Money Markets International Stockbrokers Ltd v London Stock Exchange Ltd* [2002] 1 WLR 1150, [53]–[69].

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case.[7] Prior to the Supreme Court decision in *Belmont Park Investments Pty Ltd v BNY Corporate Trustee Services Ltd*,[8] the Courts did not recognise the existence of two separate sub-rules. So, for example, the Court of Appeal in the *Belmont* case analysed the House of Lords judgment in *British Eagle International Airlines Ltd v Compagnie Nationale Air France*[9] as applying the anti-deprivation rule.[10] The distinction between the anti-deprivation rule and the pari passu rule, with *British Eagle* a leading case on the latter,[11] was recognised.

1In *Belmont* the Supreme Court of the United Kingdom considered the content and application of the anti-deprivation rule in a complex case arising from the collapse of the Lehman Brothers group of companies. That judgment also gave guidance on the separate pari passu rule. As Lord Collins noted in *Belmont*, the distinction between the rules is not clear cut, and some of the authorities can be characterised as coming under either rule.[12] The two rules do have a different scope, which the *Belmont* decision went some way to highlighting, though the boundaries of the pari passu rule, and how it inter-relates to the anti-deprivation rule, remain unclear.

1The Supreme Court's approach in *Belmont* has subsequently been applied in respect of interest rate swaps,[13] and the articles of association of the Football League.[14]

1There is little case law in New Zealand on the anti-deprivation rule. The anti-deprivation rule was considered in a case relating to personal insolvency.[15] The pari passu rule was applied by the Court of Appeal, following *British Eagle*.[16] *Belmont* has only been considered in one case.[17] As such, the case law from the United Kingdom is likely to provide persuasive authority should similar issues arise in New Zealand.

1This article considers the scope of the anti-deprivation rule, and the related pari passu rule, as it arises from these cases. For ease of reference, in this article the terms "bankruptcy" and "bankrupt estate" are used and, save as specifically indicated, should be taken to include both personal bankruptcy and company liquidation, and both the bankrupt estate and the insolvent estate of a company in liquidation. When used in connection with the anti-deprivation rule the terms also refer to a company administration and the estate of a company in administration.

Facts of the Cases

Belmont

Belmont involved complex financial instruments; Lord Mance described the contract documentation as being of a "purgatorial complexity". The case concerned a swap agreement between Lehman Brothers Special Financing Inc (LBSF) and a special purpose vehicle set up by Lehman Brothers (the Issuer). Under the swap agreement the Issuer paid to LBSF the interest on AAA-rated secure investments (the Collateral), which had been purchased by the Issuer with funds raised by the issue of notes to

[7] *Perpetual Trustee Ltd v BNY Corporate Trustee Services Ltd* [2010] Ch 347; [2009] EWCA Civ 1160, [32]–[42].

[8] *Belmont Park Investments Pty Ltd v BNY Corporate Trustee Services Ltd* [2012] 1 AC 383; [2012] UKSC 38.

[9] *British Eagle International Airlines Ltd v Compagnie Nationale Air France* [1975] 2 All ER 390.

[10] See, eg, *Perpetual Trustee Ltd v BNY Corporate Trustee Services Ltd* [2010] Ch 347; [2009] EWCA Civ 1160, [43], [50], [113]–[114], [121]. This is a joint judgment on the *Belmont* case and also on the *Butters v BBC Worldwide Ltd* case, which is discussed further below. Neuberger J, as he was then, also treated *British Eagle* as an anti-deprivation case: *Money Markets International Stockbrokers Ltd v London Stock Exchange Ltd* [2002] 1 WLR 1150, [80]–[86].

[11] *Belmont Park Investments Pty Ltd v BNY Corporate Trustee Services Ltd* [2012] 1 AC 383; [2012] UKSC 38, [7]–[8] (Lord Collins), [148] (Lord Mance).

[12] *Belmont Park Investments Pty Ltd v BNY Corporate Trustee Services Ltd* [2012] 1 AC 383; [2012] UKSC 38, [9], [14] (Lord Collins).

[13] The Carlton appeal in *Lomas v JFB Firth Rixson Inc* [2012] 2 All ER (Comm) 1076; [2012] EWCA Civ 419.

[14] *Revenue and Customs Commissioners v Football League Ltd* [2012] EWHC 1372 (Ch).

[15] *Official Assignee v NZI Life Superannuation Nominees Ltd* [1995] 1 NZLR 684.

[16] *Attorney-General v McMillan & Lockwood Ltd* [1991] 1 NZLR 53 (CA).

[17] *Sanson v Ebert Construction Ltd* [2016] NZCCLR 11; [2015] NZHC 2402.

noteholders, and LBSF paid to the Issuer the sums due to the noteholders from the Issuer. The sums due to noteholders by way of principal under the notes, and thus the periodic interest payments due to the noteholders, could be reduced by credit events occurring during the specified period by reference to one or more reference entities. The reference entities were companies unconnected to any of the parties. In effect the transaction was one in which each party was speculating on the credit performance of the reference entities. The Collateral was charged by the Issuer in favour of a trustee to secure its obligations to the noteholders and to LBSF.

The issue in the case was one of priority between LBSF and noteholders in recourse to the Collateral to pay the amounts owed to the parties respectively by the Issuer under the swap agreement and the notes. Under the various contracts, if LBSF had committed an event of default then, on early termination, Noteholder Priority applied and the noteholders had priority of payment for their claims for the outstanding principal amount owing on the notes. Otherwise Swap Counterparty Priority applied and LBSF had priority of payment for the "unwind costs" that were payable to it before noteholders were paid the amounts owing to them. The recourse of all parties against the Issuer was limited to the value of the Collateral.

LBSF committed two acts of default under the contract documentation: on 15 September 2008 Lehman Brothers Holdings Inc (LBHI) commenced Chapter 11 proceedings in the United States and on 3 October 2008 LBSF itself commenced such proceedings. The effect of the events of default was that when the swap agreement was terminated early, on 24 March 2009, Noteholder Priority applied; the noteholders were to be paid out of the Collateral in priority to LBSF. The practical effect of this was that while LBSF retained the right to payment of its claim for the unwind costs on early termination, it would in fact effectively receive nothing because the Collateral was likely to be exhausted in repaying noteholders.[18] In *Belmont* it was argued by LBSF that the flip in priority was a deprivation falling within the anti-deprivation rule, on the basis that Swap Counterparty Priority was an asset of LBSF that was impermissibly removed from LBSF's bankrupt estate, thereby depriving the creditors of LBSF of an asset for distribution under the insolvency laws.

At first instance and on appeal to the Court of Appeal it was held that there was no breach of the anti-deprivation rule. LBSF then appealed to the Supreme Court. The Supreme Court was unanimous in dismissing the appeals and gave three judgments. The leading judgment was given by Lord Collins, with whom five of the law lords agreed (Lords Walker, Philips, Hope, Clarke and Lady Hale). Lord Walker gave a short judgment agreeing with Lord Collins and adding his observations on a few points, with which four of the other law lords agreed (Lords Philips, Hope, Clarke and Lady Hale). Lord Mance gave a separate judgment. Consequently, a majority of the Court endorsed both Lord Collin's and Lord Walker's judgments.

Carlton

Lomas v JFB Firth Rixson Inc[19] (*Carlton*) was an appeal from *Lehman Brothers Special Financing Inc v Carlton Communications Ltd*,[20] which also arose from the collapse of the Lehman Brothers group of companies. *Carlton* was heard by the Court of Appeal along with a number of other appeals with similar facts. LBSF and Carlton entered into two interest rate swaps. The net effect of the two swaps was that LBSF was the fixed rate payer and Carlton was the floating rate payer. Carlton's underlying commercial purpose was to hedge its fixed interest rate exposure. The swaps expired by effluxion of time on 2 March 2009. However, prior to that time LBSF's Credit Support Provider, LBHI, was placed into Chapter 11 bankruptcy on 15 September 2008, with LBSF itself following on 3 October 2008. Both bankruptcies were events of default under the terms of the swap agreements. At the expiry of the swap, LBSF was in the money under the swap and was entitled to be paid £2.656 million by Carlton. However, under the swap agreements, the obligation of the party that was

[18] *Belmont Park Investments Pty Ltd v BNY Corporate Trustee Services Ltd* [2012] 1 AC 383; [2012] UKSC 38, [140] (Lord Mance).

[19] *Lomas v JFB Firth Rixson Inc* [2012] 2 All ER (Comm) 1076; [2012] EWCA Civ 419.

[20] *Lehman Brothers Special Financing Inc v Carlton Communications Ltd* [2011] EWHC 718 (Ch).

out of the money to pay the other party was subject to a condition precedent that there was no event of default or potential event of default by the party that was in the money. The High Court held that the effect of this was to suspend any payment obligation by the non-defaulting party until the default was remedied, and that, when the swap came to an end by effluxion of time, any suspended payment obligations, if the default had not been remedied, was then terminated. On appeal the Court of Appeal agreed that the payment obligation was suspended, but disagreed that once the swap came to an end the suspended obligations were terminated. The Court of Appeal held that the payment obligations remained suspended until the default was remedied. However, because there was no prospect of the defaults being remedied, this made little practical difference to the outcome. This meant that under the swap agreements Carlton was not obliged to pay LBSF. It was argued by LBSF that the suspension of the payment obligation violated both the anti-deprivation rule and the pari passu rule.

HMRC

Her Majesty's Revenue and Customs Commissioners v The Football League Ltd[21] (*HMRC*) involved a challenge by HMRC to the arrangements put in place by the Football League Ltd (the League). This case considered articles and rules of association between the League and its member clubs and the League's insolvency policy. The League is the body through which the 72 member clubs, each of which holds a share, collectively manage the Championship League, League 1 and League 2 football competitions in the United Kingdom. The League's functions included organising the relevant football league and other competitions, regulating the activities of member clubs and their registered players, and commercial functions including negotiating and receiving income from broadcast rights and sponsorships. Ownership of a share was a precondition to member clubs playing in the League competition and receiving income from the League. Members clubs received interim payments from the League during the year on account. However, pursuant to the relevant articles and policies, these payments only became due once the member clubs had completed all their fixture commitments in any given year. Should member clubs not do so, then the payments made to member clubs during the season were repayable to the League on demand.

The relevant articles and policy provided that:

- In certain circumstances (including an "Insolvency Event" such as the member club entering into a voluntary arrangement or becoming subject to administration or liquidation processes), the League could serve a written notice on a member club requiring it to transfer its share to such person as the League directed for 5p per share (Transfer Notice).
- The League had the power to suspend the operation of the Transfer Notice on conditions at its discretion and withdraw that notice if a particular class of creditors of the member club (called Football Creditors, which included other clubs, the club's players, managers and the League itself) were paid in full in priority to other creditors. In practice, the League suspended Transfer Notices pending a takeover or refinancing of the member club, provided that Football Creditors were paid in full.
- In the event a member club defaulted in paying amounts due to Football Creditors, amounts otherwise payable by the League to that member club were to be paid by the League to Football Creditors. As noted above, the clubs did not have any right to receive payments from the League until they had played all matches in the season. If any payments were made to Football Creditors under this provision during the season, then those sums were deducted from the amount that became payable once all matches had been played.

The HMRC contended that these arrangements were void as they contravened the anti-deprivation rule and the principle of pari passu distribution.

[21] *Her Majesty's Revenue and Customs Commissioners v The Football League Ltd* [2012] EWHC 1372 (Ch).

THE ANTI-DEPRIVATION RULE

The anti-deprivation rule is a general principle of public policy that prevents, as it was expressed in the early cases, a fraud on the insolvency statutes.[22] The rule applies equally in bankruptcy, liquidation, and administration.[23] The rule is aimed at preventing the withdrawal of assets from the bankrupt estate, thereby reducing its value to the bankrupt's creditors. For the rule to be engaged, the deprivation must: (1) be triggered by bankruptcy;[24] (2) have the effect of depriving the bankrupt estate of property;[25] (3) involve an intention to evade the insolvency laws;[26] and (4) the property deprived must not fall within one of the established exceptions to the application of the rule.

Timing of the Alleged Deprivation

The first requirement for the anti-deprivation rule's application is that the deprivation must occur on, or after, bankruptcy. In *Belmont* Lord Collins said (obiter) that the anti-deprivation rule applied equally in personal bankruptcy, liquidation of a company, or the administration of a company.[27] That issue was then considered fully in *HMRC*, with the Court concluding that this was the case. The purpose of the rule was to prevent insolvency proceedings from being undermined by dispositions of assets designed to avoid the effects of the insolvency proceeding, to the detriment of the creditors that the insolvency proceedings are designed to protect.[28] The purposes of an administration, which is as much a proceeding for the benefit of creditors as bankruptcy or liquidation, would be equally hampered or frustrated by dispositions designed to avoid the administration process. The Court held, therefore, that the anti-deprivation rule applied to a company going into administration.[29] Although the provisions relating to company administration in England and Wales are materially different from the New Zealand provisions, this conclusion is likely to hold in New Zealand.

At the level of basic principle, it makes sense that the anti-deprivation would apply when a company goes into administration. Administration, though designed to allow for an opportunity to save the company and avoid liquidation, is in essence an insolvency procedure and a company going into administration is likely to be insolvent. If an administration is unsuccessful then in most cases liquidation would be inevitable. If the rule did not apply on a company entering administration, therefore, it would allow parties an opportunity to withdraw assets prior to liquidation, and to avoid the application of the rule, increasing the chance that the administration would fail (the company having lost assets necessary to survive), and increasing the chances of liquidation with reduced assets for distribution to creditors.

A deprivation that occurs prior to the bankruptcy of the bankrupt, which must therefore have been triggered by some event other than bankruptcy, does not fall within the ambit of the rule. The rule is concerned with the bankrupt estate at the time of the initiation of bankruptcy, so a prior deprivation is not subject to the rule. A prior deprivation would have to be challenged via the various statutory powers available for the challenging of transactions preceding bankruptcy. In *Perpetual Trustee*

[22] *Belmont Park Investments Pty Ltd v BNY Corporate Trustee Services Ltd* [2012] 1 AC 383; [2012] UKSC 38, [75] (Lord Collins), [121] (Lord Walker), [148] (Lord Mance).

[23] *Belmont Park Investments Pty Ltd v BNY Corporate Trustee Services Ltd* [2012] 1 AC 383; [2012] UKSC 38, [1]; *Her Majesty's Revenue and Customs Commissioners v The Football League Ltd* [2012] EWHC 1372 (Ch), [73]–[100].

[24] *Belmont Park Investments Pty Ltd v BNY Corporate Trustee Services Ltd* [2012] 1 AC 383; [2012] UKSC 38, [14] (Lord Collins).

[25] *Belmont Park Investments Pty Ltd v BNY Corporate Trustee Services Ltd* [2012] 1 AC 383; [2012] UKSC 38, [14] (Lord Collins).

[26] *Belmont Park Investments Pty Ltd v BNY Corporate Trustee Services Ltd* [2012] 1 AC 383; [2012] UKSC 38, [78]–[79] (Lord Collins), [155] (Lord Mance).

[27] *Belmont Park Investments Pty Ltd v BNY Corporate Trustee Services Ltd* [2012] 1 AC 383; [2012] UKSC 38, [1] (Lord Collins).

[28] *Her Majesty's Revenue and Customs Commissioners v The Football League Ltd* [2012] EWHC 1372 (Ch), [96].

[29] *Her Majesty's Revenue and Customs Commissioners v The Football League Ltd* [2012] EWHC 1372 (Ch), [97] and [100].

Company Ltd v BNY Corporate Trustee Services Ltd[30] (*Perpetual*) (the *Belmont* case in the Court of Appeal), the proposition that the anti-deprivation rule applied, provided that at the time that the deprivation occurred the deprived party was insolvent, was rejected, both on the basis of precedent and the uncertainty that would arise in the application of the rule.[31]

This is illustrated in the cases. In both *Belmont* and *Carlton* the alleged deprivation, the flip in priority and the suspending of payment obligations under the swap respectively, occurred when LBHI entered into an insolvency procedure in the United States before LBSF itself did so. This meant that, as a matter of timing, the alleged deprivation occurred before the onset of LBSF's bankruptcy and the rule could not have applied to the alleged deprivation.[32] In the appeal in *Butters v BBC Worldwide Ltd* the Court of Appeal similarly held that the alleged deprivation in that case could not be caught by the rule because the trigger for the deprivation was the insolvency event of the parent company, prior to the entry into administration of the party deprived.[33]

If a deprivation occurs after bankruptcy, then it is likely that the deprivation would be invalid because of the application of the pari passu rule. That was the conclusion (obiter) of the Court of Appeal in *Perpetual*, in which the Court said that the case of *Re Garrud; Ex parte Newitt*,[34] which upheld the forfeiture of a builder's tool effected after bankruptcy, could not survive the judgment of the House of Lords in *British Eagle*.[35] Lord Collins in *Belmont* did not express a decided view, but did say that *Re Garrud; Ex parte Newitt* might still be good law.[36] Lord Mance in *Belmont* also declined to express a view.[37] The Court in *HMRC*, whilst not expressing a final view on the point, inclined strongly to the view that in the case of a default in payment of a debt after the commencement of an administration, any deprivation triggered by that default would be invalidated by the rule.[38] The Court went on to say that, regardless of the issue of the application of the anti-deprivation rule, the pari passu rule would clearly render invalid any deprivation of an asset after bankruptcy, regardless of what the trigger for that deprivation was said to be.[39] This was in effect what the Court of Appeal had said in *Perpetual* by reference to the effect of *British Eagle* on *Re Garrud; Ex parte Newitt*. Logically that should be the correct answer. If a deprivation occurs after bankruptcy, then the deprivation does deprive the bankrupt estate of an asset that was part of the bankrupt estate on bankruptcy. That would mean that the bankrupt estate had not been distributed in accordance with the relevant insolvency provisions. The Supreme Court agreed that the pari passu rule had to be strictly applied, as it was in *British Eagle*, and it follows that a post-bankruptcy deprivation would be invalid under that rule.

The Deprivation must be Triggered by Bankruptcy and must have the Effect of Reducing the Value of the Bankrupt Estate

The alleged deprivation must be triggered by bankruptcy and not for some other reason. If the deprivation is for a reason other than bankruptcy, for example because of breach of contract, then the

[30] *Perpetual Trustee Ltd v BNY Corporate Trustee Services Ltd* [2010] Ch 347; [2009] EWCA Civ 1160.

[31] *Perpetual Trustee Ltd v BNY Corporate Trustee Services Ltd* [2010] Ch 347; [2009] EWCA Civ 1160, [70]–[72].

[32] *Belmont Park Investments Pty Ltd v BNY Corporate Trustee Services Ltd* [2012] 1 AC 383; [2012] UKSC 38, [115]–[118] (Lord Collins), [134] (Lord Walker); *Lomas v JFB Firth Rixson Inc* [2012] 2 All ER (Comm) 1076; [2012] EWCA Civ 419, [93]–[94].

[33] *Perpetual Trustee Ltd v BNY Corporate Trustee Services Ltd* [2010] Ch 347; [2009] EWCA Civ 1160, [88], [99] and [162]. The judgment in *Butters* was given by the Court of Appeal in a joint judgment with their judgment in the *Belmont* case.

[34] *Re Garrud; Ex parte Newitt* (1881) 16 Ch D 522.

[35] *Perpetual Trustee Ltd v BNY Corporate Trustee Services Ltd* [2010] Ch 347; [2009] EWCA Civ 1160, [93]–[94] and [161]–[163].

[36] *Belmont Park Investments Pty Ltd v BNY Corporate Trustee Services Ltd* [2012] 1 AC 383; [2012] UKSC 38, [83] (Lord Collins).

[37] *Belmont Park Investments Pty Ltd v BNY Corporate Trustee Services Ltd* [2012] 1 AC 383; [2012] UKSC 38, [156] (Lord Mance).

[38] *Her Majesty's Revenue and Customs Commissioners v The Football League Ltd* [2012] EWHC 1372 (Ch), [155]–[157].

[39] *Her Majesty's Revenue and Customs Commissioners v The Football League Ltd* [2012] EWHC 1372 (Ch), [158].

anti-deprivation rule does not apply.[40] However, this would be unlikely to have a practical impact in the majority of cases. If the deprivation preceded bankruptcy, then the rule cannot apply. If the deprivation is triggered after bankruptcy, then regardless of the application of the anti-deprivation rule it seems reasonably clear that the deprivation would fall foul of the pari passu rule, and would be invalid. That leaves a deprivation that occurs at the same time as bankruptcy, but which is triggered for some reason other than bankruptcy. It seems unlikely that there would be many cases where a deprivation that is unrelated to the commencement of bankruptcy would coincidentally occur at the same time as the commencement of bankruptcy.

The alleged deprivation must have the effect of depriving the bankrupt estate of an asset. An analysis of the asset that is said to have been deprived is important because on analysis it might be held that in fact the bankrupt had no such property right, and that there had therefore been no deprivation. For example, Lord Mance's first basis in *Belmont* for holding that there was no deprivation was his conclusion that LBSF had no property right to any priority until the occurrence of the event determining which form of priority was to apply; so, rather than depriving LBSF of a property right, the event of default by LBSF merely prevented it from acquiring a property right to priority under the security. It followed that there had been no deprivation.[41] In *Carlton* the Court of Appeal held that there was no debt due and payable and therefore no deprivation.

If an asset is transferred on bankruptcy at market value, then there has not been a deprivation because the value of the bankrupt estate has not been reduced. This was the case in the *Butters* appeal, which involved the compulsory acquisition by BBCW of Media's minority shareholding in a joint venture company, 2e, at market value.[42] The deprivation in that case was said to arise from the combined effect of a provision allowing BBCW, following an insolvency event by Media, to compulsorily acquire Media's minority shareholding at fair value, and the termination of the licence granted by BBCW to 2e on the giving of notice by BBCW. The termination of the licence, which was 2e's main asset, would inevitably substantially reduce the value of Media's shareholding in 2e. The Court of Appeal held that the termination of the licence did not breach the rule, because, as discussed below, licences are an established exception to the anti-deprivation rule. The provision for the compulsory acquisition of the shares at market value could not breach the rule, because there was no consequent reduction in the value of the bankrupt estate. The Court of Appeal then held, overruling the High Court, that the combination of the two provisions, each of which was unobjectionable in and of themselves, could not give rise to the application of the rule.[43] In effect the Court was rejecting an argument that the rule should apply when the economic effect of the provisions was to reduce the value of the bankrupt estate, even if the provisions themselves did not breach the rule.

Purpose

The third requirement is that there was an intention on the part of the contracting parties to evade the insolvency laws, or that the transaction in question had that as its predominant purpose, or one of its main purposes. In *Belmont* none of the law lords considered that a subjective intention was necessary, but there was some difference in approach between Lord Collins and Lord Mance. Lord Collins held that a deliberate intention to evade the insolvency laws was necessary, though it was not necessary for there to be a subjective intention.[44] In many of the cases where the rule had been applied, Lord Collins considered that it was clear from the transaction that its purpose was to evade the distribution

[40] *Belmont Park Investments Pty Ltd v BNY Corporate Trustee Services Ltd* [2012] 1 AC 383; [2012] UKSC 38, [80]–[83] (Lord Collins).

[41] *Belmont Park Investments Pty Ltd v BNY Corporate Trustee Services Ltd* [2012] 1 AC 383; [2012] UKSC 38, [168] (Lord Mance).

[42] *Perpetual Trustee Ltd v BNY Corporate Trustee Services Ltd* [2010] Ch 347; [2009] EWCA Civ 1160, [86] and [148].

[43] *Perpetual Trustee Ltd v BNY Corporate Trustee Services Ltd* [2010] Ch 347; [2009] EWCA Civ 1160, [86]–[87] and [147].

[44] *Belmont Park Investments Pty Ltd v BNY Corporate Trustee Services Ltd* [2012] 1 AC 383; [2012] UKSC 38, [78]–[79] (Lord Collins).

mandated by the insolvency laws.[45] On the other hand, good faith and the commercial sense of the transaction were important factors in deciding whether there was an intention to evade the insolvency laws.[46] Lord Collins considered that there will be cases so obvious that the intention can be inferred, while in a borderline case a good faith, commercially sensible transaction should not be caught by the rule. However, a transaction that would not normally fall foul of the rule might do so if the parties were shown to have subjectively intended to evade the application of the insolvency laws.[47] Later Lord Collins summarised the rule as being "essentially directed to intentional or inevitable evasion of the principle that the debtor's property is part of the bankrupt estate".[48] Lord Collins said that:[49]

> [E]xcept in the case of a blatant attempt to deprive a party of property in the event of liquidation … the modern tendency has been to uphold commercially justifiable provisions which have been said to offend the anti-deprivation rule … The policy behind the anti-deprivation rule is clear, that the parties cannot, on bankruptcy, deprive the bankrupt of property that would otherwise be available for creditors. It is possible to give that policy a common sense application which prevents its application to bona fide commercial transactions which do not have as their predominant purpose, or one of their main purposes, the deprivation of the property of one of the parties on bankruptcy.

On Lord Collins' approach, both subjective and objective intention could be relevant to the court's inquiry into an alleged deprivation falling foul of the rule. He saw it as important that the courts uphold commercial transactions entered into in good faith when there was a sensible commercial purpose for the provision said to infringe the rule, unless it was clear (either subjectively or objectively) that the intention of the provision was to evade the insolvency laws.[50]

Lord Mance held that the test is an objective one. The court has to make an objective assessment of the purpose and effect of the relevant transaction or contractual provision, considering whether it amounts to an illegitimate evasion of the insolvency laws or has a legitimate commercial basis in other considerations.[51]

There are at least two factors that, if applicable in a given case, may be relevant to the question as to whether or not this part of the test will be satisfied. The first factor is when the asset is a chose in action, executory in nature, which from its inception allowed for the adjustment of the asset on bankruptcy. The other factor is when the asset in question was provided in substance by the party benefiting from the alleged deprivation, in particular where the bankrupt provided in return promises that are executory in nature. If either, or both, of these circumstances apply, then they are pointers towards the arrangements being legitimate commercial arrangements, rather than arrangements made with the purpose of evading the application of the insolvency law. These matters are discussed separately below.

It is also important to note that it follows from the fact that there can be a valid deprivation of an asset on bankruptcy, that purpose cannot simply be equated with effect. Any deprivation of an asset on bankruptcy, to which the rule can apply, involves a reduction in the value of the bankrupt estate, and therefore has the effect of prejudicing creditors. If effect and purpose were equated then the rule would apply in all cases.

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[45] *Belmont Park Investments Pty Ltd v BNY Corporate Trustee Services Ltd* [2012] 1 AC 383; [2012] UKSC 38, [75]–[76] (Lord Collins).

[46] *Belmont Park Investments Pty Ltd v BNY Corporate Trustee Services Ltd* [2012] 1 AC 383; [2012] UKSC 38, [77] (Lord Collins).

[47] *Belmont Park Investments Pty Ltd v BNY Corporate Trustee Services Ltd* [2012] 1 AC 383; [2012] UKSC 38, [79] (Lord Collins).

[48] *Belmont Park Investments Pty Ltd v BNY Corporate Trustee Services Ltd* [2012] 1 AC 383; [2012] UKSC 38, [106] (Lord Collins).

[49] *Belmont Park Investments Pty Ltd v BNY Corporate Trustee Services Ltd* [2012] 1 AC 383; [2012] UKSC 38, [104] (Lord Collins).

[50] *Belmont Park Investments Pty Ltd v BNY Corporate Trustee Services Ltd* [2012] 1 AC 383; [2012] UKSC 38, [103]–[106] (Lord Collins).

[51] *Belmont Park Investments Pty Ltd v BNY Corporate Trustee Services Ltd* [2012] 1 AC 383; [2012] UKSC 38, [151]–[155] (Lord Mance).

Exceptions to the Rule

The asset deprived must not fall into one of the classes which are established exceptions to the rule, principally leases and licences.[52] Leases and licences may be validly terminated on bankruptcy without engaging the anti-deprivation rule. This is discussed further below.

Overall Test

In essence then, whether a deprivation falls foul of the rule or not is a matter of judgment for the courts, looking objectively at the substance of the transaction or contractual provision, and determining whether the deprivation is an illegitimate attempt to avoid the insolvency laws, or whether it is a good faith, commercially sensible transaction that should not be disturbed. If a subjective intention to evade the insolvency laws is established, then in some cases the rule will apply to a deprivation that on the objective approach would not otherwise be caught. The rule will fall to be considered and applied on a case-by-case basis.

Matters Relevant to the Application of the Anti-deprivation Rule

Leases, Licences and "Flawed Assets"

As noted above, leases and licences are an established exception to the anti-deprivation rule, as confirmed by the Supreme Court.[53] Any provision cancelling a lease or licence on the bankruptcy of the lessee or licensee will not, therefore, be caught by the rule.

The distinction in these cases was between:[54]

- an interest determinable on bankruptcy/liquidation. The determinable interest granted is an interest the quantum of which is limited by the stipulated event, so that the occurrence of the event marks the end of the duration of the interest; and
- an absolute interest made defeasible on bankruptcy/liquidation by a condition subsequent. In this latter case what is granted is a defeasible interest, which is a full interest that is granted outright and then forfeited.

The recognised exceptions for limited property rights (leases/licences) can be understood as being consistent with the basic principle because of the general rule that the trustee (in New Zealand the Official Assignee) or liquidator takes no better title to property than the title possessed by the bankrupt or insolvent company.[55] If the property interest is validly limited by bankruptcy, then there is no deprivation; the bankrupt estate after bankruptcy retains the same limited property right that the bankrupt possessed prior to bankruptcy. The difficulty becomes, once consideration extends beyond the accepted limited property rights which are exceptions to the rule, how to distinguish between limited property rights that are validly limited by bankruptcy from those that are not. As the judgments in *Belmont* note, the distinction is one that has been subject to much criticism because it can turn on fine verbal distinctions.[56] Such a distinction threatens to empty the anti-deprivation rule of all content if contracting parties are able to limit a property right merely by inserting a flaw triggered on bankruptcy in their contract from the beginning. However, the distinction is an established one and there have been few positive suggestions about how to replace it.[57]

[52] *Belmont Park Investments Pty Ltd v BNY Corporate Trustee Services Ltd* [2012] 1 AC 383; [2012] UKSC 38, [85]–[86] (Lord Collins), [123] (Lord Walker), [158] (Lord Mance).

[53] *Belmont Park Investments Pty Ltd v BNY Corporate Trustee Services Ltd* [2012] 1 AC 383; [2012] UKSC 38, [85]–[86] (Lord Collins), [123] (Lord Walker), [158] (Lord Mance).

[54] *Belmont Park Investments Pty Ltd v BNY Corporate Trustee Services Ltd* [2012] 1 AC 383; [2012] UKSC 38, [87] (Lord Collins).

[55] *British Eagle International Airlines Ltd v Compagnie Nationale Air France* [1975] 2 All ER 390, 401 (Lord Morris).

[56] *Belmont Park Investments Pty Ltd v BNY Corporate Trustee Services Ltd* [2012] 1 AC 383; [2012] UKSC 38, [87] (Lord Collins), [162] (Lord Mance).

[57] *Belmont Park Investments Pty Ltd v BNY Corporate Trustee Services Ltd* [2012] 1 AC 383; [2012] UKSC 38, [88] (Lord Collins), [163] (Lord Mance).

This distinction gave rise to the "flawed asset theory", to the effect that the law should recognise and give effect to arrangements whereby it was an inherent feature of an asset from the inception of its grant that it could be taken away from the grantee, whether in the event of insolvency or otherwise. This theory received some support from the judgment of Patten LJ in *Perpetual*.[58] The flawed asset theory was advanced by a party in *Lomas v JFB Firth Rixson Inc*[59] (*Firth Rixson*), another interest swap case with facts similar to *Carlton* and using the same contractual documents, in reliance on Patten LJ's minority judgment in the *Perpetual*. Briggs J (as he then was) rejected the argument that the insertion of the contingency in Lehman Brothers International Europe's (LBIE) rights, engaged by its default in the contractual documents *ab initio*, was of itself sufficient to avoid the application of the anti-deprivation rule to that contingency.[60] However, he recognised that in the case law, in some circumstances, the *ab initio* creation of a flaw of an asset had been caught by the rule and in others it had not. The question was to understand why the flaw triggered the rule in some cases but not in others. Briggs J held that the crucial distinction was whether the asset was a chose in action of the insolvent company that represented a quid pro quo for something already done or for something still to be done (in whole or in part) by the other party. In the former case (ie where the promises were executed in nature) the court would be slow to permit the flaw to stand; in the latter case (where the promises were executory in nature) the court would more readily permit the insertion of the flaw *ab initio*, "there being nothing contrary to insolvency law in permitting a party either to terminate or adjust what would otherwise be an ongoing relationship with the insolvent company, at the point it goes into an insolvency process".[61] Briggs J saw leases and licences as examples of the executory contract situation, where the right to enjoy the underlying asset accrues over time in exchange over time for payment of rent or fees.[62] Because the anti-deprivation rule is only concerned with attempts to evade the insolvency laws, it follows that if there is nothing contrary to insolvency law in terminating or adjusting an ongoing relationship on bankruptcy, the rule does not apply.

Like Briggs J in *Firth Rixson*, the Supreme Court in *Belmont*, while accepting the currently recognised exceptions, such as leases and licences, rejected the flawed asset theory. If the theory applied it would empty the anti-deprivation rule of all content, as it could always be avoided by careful drafting of contractual arrangements.[63] Lord Collins chose not to express a view on the distinction drawn by Briggs J in *Carlton* as to the approach of the courts to executory contracts, other than to say that accrued property rights, such as debts in those cases, must at least be capable of being caught by the rule.[64]

However, a majority of the Supreme Court in *Belmont* agreed with Lord Walker's separate judgment. Lord Walker held that even in fully commercial transactions, if the bankrupt was not in substance the provider of the asset of which he is to be divested, then the anti-deprivation rule may not apply. If a party brings no more to the transaction than his covenant then the property interest which he takes is what the other party agrees to grant him.[65] Lord Walker said that this was the approach that

58 *Perpetual Trustee Ltd v BNY Corporate Trustee Services Ltd* [2010] Ch 347; [2009] EWCA Civ 1160, [135].

59 *Lomas v JFB Firth Rixson Inc* [2010] EWHC 3372 (Ch).

60 *Lomas v JFB Firth Rixson Inc* [2010] EWHC 3372 (Ch), [107].

61 *Lomas v JFB Firth Rixson Inc* [2010] EWHC 3372 (Ch), [108].

62 *Lomas v JFB Firth Rixson Inc* [2010] EWHC 3372 (Ch), [110].

63 *Belmont Park Investments Pty Ltd v BNY Corporate Trustee Services Ltd* [2012] 1 AC 383; [2012] UKSC 38, [89] (Lord Collins).

64 *Belmont Park Investments Pty Ltd v BNY Corporate Trustee Services Ltd* [2012] 1 AC 383; [2012] UKSC 38, [101] (Lord Collins).

65 *Belmont Park Investments Pty Ltd v BNY Corporate Trustee Services Ltd* [2012] 1 AC 383; [2012] UKSC 38, [129] (Lord Walker).

Briggs J (as he then was) had taken in *Firth Rixson* and that the distinction drawn by Briggs J in that case was "a valuable contribution to the search for principle in this area", albeit that the proposed test lacked precision.[66]

Lord Mance agreed that when the contract provides for future performance of reciprocal obligations, which are the quid pro quo of each other, the contract can be cancelled on bankruptcy without violating the rule. However, Lord Mance also considered that where rights had accrued, or where a right was independent of an unperformed obligation, a deprivation of those rights could be caught by the rule.[67]

The majority of the Supreme Court in *Belmont*, therefore, approved the distinction and the principle set out in *Carlton*. It follows that when a chose in action is created with a flaw triggered by bankruptcy, the courts are likely to find that the determination of that chose in action on bankruptcy, when it is executory in nature at the time of bankruptcy, is not caught by the anti-deprivation rule. However, to the extent that the deprivation also includes accrued rights as at the date of bankruptcy, it would be likely to be invalid.

Does the Source of the Asset Deprived Matter?

In *Perpetual* the Court of Appeal relied upon the fact that the noteholders had been the source of the funds to purchase the Collateral as an important factor in finding that the flip in priority did not breach the anti-deprivation rule.[68] Lord Collins in *Belmont* considered that the authorities suggested that the source of the assets was an important element in determining whether there was a fraud on the insolvency laws. However, there could be no general and universal exception to the application of the rule where the recipient of the deprived asset was the source of that asset.[69] This must be right, for an exception so broadly stated would undermine the insolvency laws. He went on to say that if the beneficiary of the deprivation was the source of the asset, then this might be an important, and in some cases, decisive factor in concluding that the transaction was a good faith commercial transaction and thus outside the scope of the rule.[70]

As discussed above, Lord Walker considered that if the bankrupt was not in substance the provider of the asset which is divested on bankruptcy then the rule may not apply. Some weight was to be given to what the bankrupt has brought to the transaction *in substance* when considering whether the rule applies. In the transaction in *Belmont* the noteholders were the only persons contributing any assets in substance, while LBSF was contributing only promises which it then proved unable to perform.[71]

Lord Mance did not accept Lord Collins' reasoning and did not consider that the noteholders' funding of the security provided a basis for justifying the deprivation.[72]

THE PARI PASSU RULE

The Supreme Court in *Belmont* drew a clear distinction between the anti-deprivation rule and the pari passu rule. The Court of Appeal in *Belmont* had not made this distinction, analysing the authorities on

[66] *Belmont Park Investments Pty Ltd v BNY Corporate Trustee Services Ltd* [2012] 1 AC 383; [2012] UKSC 38, [130]–[131] (Lord Walker).

[67] *Belmont Park Investments Pty Ltd v BNY Corporate Trustee Services Ltd* [2012] 1 AC 383; [2012] UKSC 38, [176]–[177] (Lord Mance).

[68] *Perpetual Trustee Ltd v BNY Corporate Trustee Services Ltd* [2010] Ch 347; [2009] EWCA Civ 1160, [67].

[69] *Belmont Park Investments Pty Ltd v BNY Corporate Trustee Services Ltd* [2012] 1 AC 383; [2012] UKSC 38, [97]–[98] (Lord Collins).

[70] *Belmont Park Investments Pty Ltd v BNY Corporate Trustee Services Ltd* [2012] 1 AC 383; [2012] UKSC 38, [98] (Lord Collins).

[71] *Belmont Park Investments Pty Ltd v BNY Corporate Trustee Services Ltd* [2012] 1 AC 383; [2012] UKSC 38, [129]–[132] (Lord Walker).

[72] *Belmont Park Investments Pty Ltd v BNY Corporate Trustee Services Ltd* [2012] 1 AC 383; [2012] UKSC 38, [170]–[171] (Lord Mance).

the basis that there was only one rule. The pari passu principle, embodied in the insolvency legislation, is designed to secure the equal participation for creditors in such of the bankrupt's property as is available in the liquidation; it is a policy of collective realisation.[73] The rule provides that it is contrary to public policy to contract out of pari passu distribution, as provided for in the relevant insolvency legislation.[74] This rule, like the anti-deprivation rule, falls under the general principle that parties cannot contract out of the legislation governing insolvency.[75]

The anti-deprivation rule concerns attempts to remove assets from insolvency proceedings, which reduces the value of the bankrupt estate to the detriment of creditors. The pari passu rule concerns attempts to contract out of the statutory provisions for pro rata distribution, so that one creditor receives more than his or her proper share of the available assets.[76] Lord Mance said that the anti-deprivation rule addresses what happens *on* bankruptcy, while the pari passu rule addresses what happens *in* bankruptcy.[77] The two rules overlap and many of the cases can be analysed under either rule.[78]

There are important distinctions in the scope of the two rules and in how they apply. Perhaps the key difference between the two rules is that the pari passu rule does not require the purpose of the offending arrangement to have been to evade the law;[79] the rule is concerned only with the *effect* of the arrangements. If the effect of the arrangements is to cause the bankrupt estate to be distributed otherwise than in accordance with the statutory rules, then the pari passu rule is engaged and the arrangements are void to the extent that they have that effect. This means that the commercial basis for the arrangement is irrelevant. As the Court of Appeal held in *Carlton*, "the [pari passu] rule … applies almost without qualification to any property of the bankrupt estate and does not depend for its application on questions of commerciality and good faith".[80] When the pari passu rule can be shown to apply, a stricter approach is applied by the Courts, and this stricter approach is likely to encourage plaintiffs to try to fit a case of an alleged deprivation into the pari passu rule, as the plaintiff did on appeal in *Carlton* (following the judgment in *Belmont*), and in *HMRC*. The pari passu rule also applies to any distribution, whether or not it is expressly triggered by bankruptcy.[81]

There are some similarities between the pari passu rule and the anti-deprivation rule:

- Timing may be a key issue. The pari passu rule only bites on the estate of the bankrupt at the time of bankruptcy. If the asset in question was removed before bankruptcy, then the pari passu rule is inapplicable. In those circumstances, the asset was not part of the bankrupt estate and there cannot have been any breach of the statutory rules governing the distribution of that estate.
- If the asset has been paid for at market value, then there can be no application of the pari passu rule. In those circumstances, the bankrupt estate available for distribution has not suffered any deprivation, the asset in question having been replaced by its equivalent value.

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[73] *Allied Concrete Ltd v Meltzer* [2016] 1 NZLR 141; [2015] NZSC 7, [95]–[96].

[74] Note that there is an exception to the rule which allows a creditor to contract out of the statutory pari passu distribution provisions by voluntarily subordinating his or her claim in bankruptcy: *Stotter v Ararimu Holdings Ltd* [1994] 2 NZLR 53 (CA), which is discussed below.

[75] *Belmont Park Investments Pty Ltd v BNY Corporate Trustee Services Ltd* [2012] 1 AC 383; [2012] UKSC 38, [1] (Lord Collins), [148] (Lord Mance).

[76] *Belmont Park Investments Pty Ltd v BNY Corporate Trustee Services Ltd* [2012] 1 AC 383; [2012] UKSC 38, [1] (Lord Collins).

[77] *Belmont Park Investments Pty Ltd v BNY Corporate Trustee Services Ltd* [2012] 1 AC 383; [2012] UKSC 38, [149] (Lord Mance) (emphasis added).

[78] *Belmont Park Investments Pty Ltd v BNY Corporate Trustee Services Ltd* [2012] 1 AC 383; [2012] UKSC 38, [9] (Lord Collins), [149] (Lord Mance).

[79] *Belmont Park Investments Pty Ltd v BNY Corporate Trustee Services Ltd* [2012] 1 AC 383; [2012] UKSC 38, [78] (Lord Collins).

[80] *Lomas v JFB Firth Rixson Inc* [2012] 2 All ER (Comm) 1076; [2012] EWCA Civ 419, [95].

[81] *Belmont Park Investments Pty Ltd v BNY Corporate Trustee Services Ltd* [2012] 1 AC 383; [2012] UKSC 38, [14] (Lord Collins); *Her Majesty's Revenue and Customs Commissioners v The Football League Ltd* [2012] EWHC 1372 (Ch), [65]–[66].

- Analysis of the asset at issue may be important. As some of the cases show, on analysis it may be held that the bankrupt's estate never included the asset in question. This is well illustrated by the minority judgments in *British Eagle* and in the subsequent judgment of the High Court of Australia in *International Air Transport Association v Ansett Australia Holdings Ltd*[82] (*IATA v Ansett*) which are discussed below.

In *HMRC* the pari passu rule was held only to apply in the context of a company administration when the administrator, under the provisions applicable in England and Wales, gave notice that there was to be a distribution. Under the relevant statutory provisions, a distribution by an administrator had to be made on a pari passu basis. The pari passu rule could not apply prior to that time in a company administration, because it was only if a distribution was to be made that pari passu distribution was required under the statutory scheme.[83] By contrast, from the time that bankruptcy or liquidation commences, the purpose of the insolvency procedure is to make a distribution on a pari passu basis. In those insolvency proceedings, therefore, the rule is engaged from their commencement.[84] The legislative scheme in New Zealand for company administrations is different, with no provisions for distribution by the administrator, and with no direct application of the pari passu principle. The pari passu rule, therefore, would be unlikely to apply at all in a company administration in New Zealand.[85]

A prime example of the application of the pari passu rule is the House of Lords' decision in *British Eagle*.[86] The case dealt with the International Air Transport Association (IATA) clearing house system. IATA established a clearing house for member airlines to simplify the settlement of claims between international airlines that carried passengers or freight on behalf of each other. Under the clearing house rules, claims were cleared every month with all claims by a member for services performed for other members, and all claims by other members for services provided to that member, netted off by the clearing house. Prior to clearance these were entered in the clearing house as credits and debits against each member's account. As a consequence, after each monthly clearance, each member either paid to the clearing house its net debit or received from the clearing house a payment equal to its net credit. Members made no payments inter se.

British Eagle went into liquidation on 8 November 1968. Between the last clearance that had been made and the date of liquidation, looking at British Eagle's bilateral relationships, British Eagle was a net creditor with respect to various members for £27,337 and a net debtor with respect to other members for £174,455.[87] The liquidators sought to recover in full the net £27,337 owing to British Eagle from members where the services rendered had exceeded the services used by British Eagle, while leaving the other members to prove in the liquidation for the £174,455 in net debts owed by British Eagle. The liquidators considered that the clearing house rules were not binding on the basis that they ran counter to the principles of the insolvency legislation (pari passu distribution). It was said that the effect of the arrangements was that debts owing to British Eagle were applied not for the general benefit of all creditors, but exclusively for the benefit of the creditors who were members of the clearing house. Those creditors, in effect, received the full benefit of those debts in reducing the sums owed by British Eagle to them.

[82] *International Air Transport Association v Ansett Australia Holdings Ltd* (2008) 234 CLR 151; 82 ALJR 419; [2008] HCA 3.

[83] *Her Majesty's Revenue and Customs Commissioners v The Football League Ltd* [2012] EWHC 1372 (Ch), [78]–[89].

[84] *Her Majesty's Revenue and Customs Commissioners v The Football League Ltd* [2012] EWHC 1372 (Ch), [89].

[85] It is possible that the pari passu principle may have some indirect application to a deed of company arrangement (DOCA), via the power of the Court in s 239ADD(2)(d) of the *Companies Act 1993* (NZ) to terminate a DOCA where it is oppressive or unfairly prejudicial, or unfairly discriminatory, to one or more of the creditors. It has been suggested that an administrator needs to "examine the proposal carefully to ensure that the less advantaged creditors are not unfairly prejudiced and in particular to ensure, so far as possible, that the deed is no less beneficial to all creditors than a liquidation is likely to be": Paul Heath and Michael Whale, *Heath and Whale on Insolvency* (LexisNexis, New Zealand, subscription service) [17.105]. If that is so, indirect consideration of the pari passu principle could be relevant to the court's discretion under s 239ADD whether or not to terminate a DOCA. However, the court's action in terminating a DOCA would be based on the statutory power in s 239ADD and the pari passu rule would not be engaged.

[86] *British Eagle International Airlines Ltd v Compagnie Nationale Air France* [1975] 2 All ER 390.

[87] *British Eagle International Airlines Ltd v Compagnie Nationale Air France* [1975] 2 All ER 390, 400 (Lord Morris).

The majority of the House of Lords accepted that the clearing transaction was a sensible commercial transaction and that there was no intention to circumvent the insolvency legislation. However, that was irrelevant to the outcome. The application of the pari passu rule[88] in *British Eagle* depended on whether debts arose as between individual members of the clearing house when services were rendered between those members. If bilateral debts did arise, then those debts were assets of any airline that provided services and formed a part of the bankrupt estate of the airline on liquidation. It would also follow from that conclusion that the clearing house arrangements were, in effect, an attempt to contract out of the statutory regime for distribution of the airline's assets. Under the clearing house rules, those debts were applied to reduce the particular airline's debt to other members of the clearing house, rather than being distributed for the benefit of all creditors under the applicable statutory rules. On the other hand, if there were no bilateral debts arising, then an airline's only right was to payment by the clearing house of any net credits in any given monthly clearance and there could be no breach of the pari passu rule under the clearing house arrangements.

In *British Eagle* six of the judges who considered the case held that no bilateral debts arose and that there was, therefore, no breach of the rule (the judge at first instance, the Court of Appeal unanimously, and the minority in the House of Lords); and three judges held that bilateral debts did arise (the majority in the House of Lords). The effect of the majority decision in the House of Lords was that the clearing house rules were held to be void insofar as they breached the pari passu rule.[89] In *Belmont* Lord Collins approved the formulation of the ratio of *British Eagle* as expressed in *Carreras Rothmans Ltd v Freeman Mathews Treasure Ltd*:[90]

> [W]here the effect of a contract is that an asset which is actually owned by a company at the commencement of its liquidation would be dealt with in a way other than in accordance with [the statutory pari passu rule] … then to that extent the contract as a matter of public policy is avoided.

Following the judgment in *British Eagle*, IATA changed its rules so as to prevent bilateral debts arising between its members, in order to overcome the House of Lords decision. The new rules were then tested in Australia following the collapse of Ansett in *IATA v Ansett*. The High Court, by a 6–1 majority, held that no bilateral debts arose under the amended regulations and there was, therefore, no inconsistency with the insolvency legislation. The pari passu rule, therefore, could not apply to invalidate the arrangements. It is worth noting that, at first instance in *Carlton*, the Court used the *IATA v Ansett* case as an example of how clever drafting had avoided application of the rule, without any change in the underlying economic realities.[91]

The Rules Do Not Give the Courts Jurisdiction to Rewrite the Parties' Contracts

The anti-deprivation and pari passu rules allow the courts to invalidate the arrangements between the parties when and to the extent that the rules apply to the arrangements in question. While any such invalidation will affect the parties' respective legal rights, and will have the consequence of altering the bargain between the parties to the extent of the invalidity, the rules do not give the courts the jurisdiction to go further and to rewrite the contract between the parties.

So, for example, if the effect of the parties' arrangements is to prevent a property right from arising in the circumstances, such that the two rules cannot apply, then the rules do not provide the courts with jurisdiction to rewrite the parties' contract, so as to create a property right when none had existed. In *IATA v Ansett*, the High Court of Australia rejected an argument that if the IATA regulations were effective in avoiding the creating of individual debts between members of the clearing house,

[88] Note that the House of Lords did use this term.

[89] *Carreras Rothmans Ltd v Freeman Mathews Treasure Ltd* [1985] 1 All ER 155 (Ch), 168. It should be noted that in New Zealand the *Companies Act 1993* (NZ) ss 310A–310O expressly provides for clearing house arrangements of the type at issue in *British Eagle*.

[90] *Belmont Park Investments Pty Ltd v BNY Corporate Trustee Services Ltd* [2012] 1 AC 383; [2012] UKSC 38, [8] (Lord Collins).

[91] *Lomas v JFB Firth Rixson Inc* [2012] 2 All ER (Comm) 1076; [2012] EWCA Civ 419, [95].

then they should be void to that extent, on a public policy basis, as an impermissible contracting out of the statutory scheme. The majority held that there was an important distinction between rendering a contractual provision invalid and creating a contract to which the parties had never agreed. Because the regulations were effective in limiting the rights of the parties to rights vis-à-vis the clearing house, with no creation of debts as between members, the Court could not simply rewrite that contract to create debts between members. It was one thing for the courts to render a provision void that resulted in property rights arising from the parties' relationship from being distributed contrary to the insolvency legislation; it was another to impose a relationship of debtor and creditor on the parties contrary to their agreement.[92]

Nor does the requirement for the courts to look at the substance of a transaction mean that the courts can "disregard the legal rights and obligations created by the contract in favour of different rights and obligations which are said to better reflect the commercial realities between the parties".[93] If there was a material disconnect between the legal rights and obligations reflected in the contract and the economic substance of the transaction, then that might, to the extent that the economic substance pointed to the purpose of the arrangements being evasion of the bankruptcy laws, be a factor weighing against the arrangement being a good faith commercial transaction. The rules do not, however, allow the courts to alter the contractual rights and obligations, save by invalidating those rights and obligations to the extent that they breach the rule.

Not a General Anti-avoidance Principle that can be Expanded Beyond Its Recognised Scope

The anti-deprivation rule originally developed before the enactment of the modern statutory schemes governing bankruptcy, including in particular the wide statutory powers for the challenge of pre-bankruptcy transactions.[94] Despite this, the Supreme Court declined to re-write the case law, established over 200 years, on the basis of the modern statutory developments and applied the anti-deprivation as it was reflected in the existing common law.[95] The case law supports the view that the courts are unlikely to be prepared to extend the rule beyond its established scope, as reflected in *Belmont*. For example, the Court in *HMRC* held that the anti-deprivation rule is not a general anti-avoidance principle that can be engaged whenever the effect of the relevant provisions at issue taken as a whole was to produce a different order of priorities than prescribed by insolvency law. Broader or different restrictions would require statutory intervention.[96] The requirement to show, objectively, that the parties intended, or had as their purpose, the evasion of the insolvency laws, and the way the rule has been applied, demonstrates that the rule, and therefore the underlying public policy, is not engaged merely because the deprivation has the effect of removing property from the bankrupt estate that would otherwise be available to creditors. This is also reflected in the *Butters* appeal, in which the Court of Appeal rejected submissions that the combined effect of two unobjectionable provisions was such that the provisions should be set aside. The High Court of Australia in *IATA v Ansett* similarly rejected arguments that sought to engage the rules simply on the basis of the economic effect of the arrangements.[97] An expansion of the rule beyond its established scope, on the basis of arguments grounded on the underlying principle of public policy, would also run

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[92] *International Air Transport Association v Ansett Australia Holdings Ltd* (2008) 234 CLR 151; 82 ALJR 419; [2008] HCA 3, [27]–[28].

[93] *Her Majesty's Revenue and Customs Commissioners v The Football League Ltd* [2012] EWHC 1372 (Ch), [133].

[94] *Belmont Park Investments Pty Ltd v BNY Corporate Trustee Services Ltd* [2012] 1 AC 383; [2012] UKSC 38, [16] (Lord Collins).

[95] *Belmont Park Investments Pty Ltd v BNY Corporate Trustee Services Ltd* [2012] 1 AC 383; [2012] UKSC 38, [102] (Lord Collins).

[96] *Her Majesty's Revenue and Customs Commissioners v The Football League Ltd* [2012] EWHC 1372 (Ch), [188].

[97] *International Air Transport Association v Ansett Australia Holdings Ltd* (2008) 234 CLR 151; 82 ALJR 419; [2008] HCA 3, [27]–[29] (Gleeson CJ) and implicitly in the judgment of the remainder of the majority.

counter to the modern tendency to uphold commercially justifiable contractual provisions.[98] If the commercial arrangements in question do not fall foul of the anti-deprivation rule, and cannot be challenged under the statutory provisions, then appeal to public policy should not be enough to invalidate the arrangements.

Application of the Rules in Belmont, Carlton and HMRC

Belmont

The law lords differed over the nature of the property right of which LBSF was said to have been deprived. Lord Collins considered that the property was a chose in action (a security interest) created in circumstances where the collateral covered by the security was, as a matter of substance, provided by the noteholders, and where the property right was always subject to a potential change in priorities.[99] Lord Walker saw the property as a chose in action with a built-in flaw, triggered by bankruptcy, that was executory in nature. The Collateral in substance was provided solely by noteholders, while LBSF provided only promises in exchange for its rights under the chose in action, and then proved unable to fulfil those promises. LBSF's only proprietary interest was a charge to secure sums that might become due to LBSF on the due performance of LBSF's obligations.[100] As noted above, Lord Mance's view was that LBSF never had a proprietary right to priority under the security, because no proprietary rights arose until the event that determined which priority was to apply. Alternatively, Lord Mance considered that, if LBSF had a property right to priority under the security, that right was within the category of interests limited to last until a certain event, which are not caught by the rule.[101]

The Supreme Court held that the flip was not a deprivation caught by the anti-deprivation rule because the transaction in question was a complex commercial transaction entered into in good faith, the substance of which was the provision of the security by the noteholders, which was always subject to a potential change in priorities.[102] The insolvency of LBSF was a trigger (but not the only trigger) for the deprivation. In his conclusions Lord Collins said that there had never been any suggestion that the provisions were deliberately intended to evade insolvency law, and that this was obvious because the Events of Default included a wide range of non-insolvency circumstances.[103]

An additional ground for rejecting the appeal was the fact that the claimed deprivation occurred prior in time to LBSF's bankruptcy and not because of LBSF's bankruptcy.[104]

The pari passu rule was not at issue in *Belmont*.

It is worthy of note that a United States Court reached the opposite conclusion to the Supreme Court in relation to the same transaction on the basis of the US Bankruptcy Code and its prohibition of

98 *Belmont Park Investments Pty Ltd v BNY Corporate Trustee Services Ltd* [2012] 1 AC 383; [2012] UKSC 38, [104] (Lord Collins).

99 *Belmont Park Investments Pty Ltd v BNY Corporate Trustee Services Ltd* [2012] 1 AC 383; [2012] UKSC 38, [107]–[108] (Lord Collins).

100 *Belmont Park Investments Pty Ltd v BNY Corporate Trustee Services Ltd* [2012] 1 AC 383; [2012] UKSC 38, [130]–[132] (Lord Walker).

101 *Belmont Park Investments Pty Ltd v BNY Corporate Trustee Services Ltd* [2012] 1 AC 383; [2012] UKSC 38, [168] (Lord Mance).

102 *Belmont Park Investments Pty Ltd v BNY Corporate Trustee Services Ltd* [2012] 1 AC 383; [2012] UKSC 38, [108] (Lord Collins), [133] (Lord Walker).

103 *Belmont Park Investments Pty Ltd v BNY Corporate Trustee Services Ltd* [2012] 1 AC 383; [2012] UKSC 38, [109] (Lord Collins).

104 *Belmont Park Investments Pty Ltd v BNY Corporate Trustee Services Ltd* [2012] 1 AC 383; [2012] UKSC 38, [115], [117]–[118] (Lord Collins), [134] (Lord Walker).

ipso facto clauses.[105] A later judgment, in relation to other transactions of a similar type, involving a flip in priority, came to the opposite conclusion.[106]

Carlton

In *Carlton* the Court of Appeal held that the anti-deprivation rule was not engaged by the suspension of Carlton's payment obligations to LBSF while LBSF was in default. The suspension of the payment obligations of the non-defaulting party for the period of default did no more than prevent Carlton from having to make payments under a hedging arrangement with a bankrupt counterparty. There was no suggestion the provision was formulated to avoid the effect of insolvency law or to give Carlton a preference as creditor of the bankrupt.[107] The suspensory effect fell into the executory class of flawed assets in Briggs J's test from *Firth Rixson*, and there was no suggestion that the provision in question could affect recovery of sums that became due and payable before the event of default.[108] The purpose of the relevant provision was to protect the non-defaulting party from the additional credit risk involved in performing its own obligations while the defaulting counterparty remained unable to meet its own. As such, the provision was an acceptable commercial rearrangement of rights to reflect the economic consequences of insolvency, rather than an attempt to pre-empt the distribution of assets in a bankrupt estate.[109] Furthermore, because the provision in question was engaged by the bankruptcy of LBHI prior to LBSF's bankruptcy, the anti-deprivation rule could not apply.[110]

The pari passu rule could not apply because there was no debt payable to LBSF when its bankruptcy commenced. The suspensory provision could not breach the rule because the obligation to pay was subject to the condition precedent that there was no event of default. The provision operated at most to prevent the relevant debt ever becoming payable, so that there was no property capable of being distributed, and no deprivation.[111] Furthermore, Carlton was not a creditor of LBSF, but a debtor. The pari passu rule could be engaged by a debtor relying on contractual arrangements to resist payment, when the arrangements offended the rule, as in *British Eagle*, but that would be likely to be unusual. In this case Carlton's status as a debtor confirmed that the real issue was not how the payment that would have been due from Carlton was to be distributed, but whether it was payable at all.[112]

HMRC

The Court held that, in principle, both rules will apply if a member club goes into liquidation, while only the anti-deprivation rule will apply if it goes into administration, unless the administrator issues a notice of proposed distribution. This is because the principle of pari passu distribution is only triggered when the purpose of the insolvency procedure in question is to effect a distribution. In a typical football insolvency, a member club would enter into administration and eventually make distributions by means of a company voluntary arrangement. This would not offend the pari passu rule as this would not involve a distribution being made by the administrator.

The existence of a debt to a member club in terms of payments by the League, and accordingly the applicability of the two rules specifically, would depend on whether the administration or

[105] *Re Lehman Brothers Holdings Inc; Lehman Brothers Special Financing Inc v BNY Corporate Trustee Services Ltd*, 422 BR 407 (2010). This judgment was given by Judge Peck after the Court of Appeal judgment in the *Belmont* case, but before the Supreme Court gave its judgment. Judge Peck recorded the English decisions and also considered comity issues in his judgment. Judge Peck gave a similar decision in relation to other similar transactions in *Re Lehman Brothers Holdings Inc; Lehman Brothers Special Financing Inc v Ballyrock ABS CDO 2007-1 Ltd*, 452 BR 31 (2011).

[106] *Re Lehman Brothers Holdings Inc; Lehman Brothers Special Financing Inc v Bank of America National Association*, 553 BR 476 (2016).

[107] *Lomas v JFB Firth Rixson Inc* [2012] 2 All ER (Comm) 1076; [2012] EWCA Civ 419, [87].

[108] *Lomas v JFB Firth Rixson Inc* [2012] 2 All ER (Comm) 1076; [2012] EWCA Civ 419, [88]–[90].

[109] *Lomas v JFB Firth Rixson Inc* [2012] 2 All ER (Comm) 1076; [2012] EWCA Civ 419, [91]–[92].

[110] *Lomas v JFB Firth Rixson Inc* [2012] 2 All ER (Comm) 1076; [2012] EWCA Civ 419, [93].

[111] *Lomas v JFB Firth Rixson Inc* [2012] 2 All ER (Comm) 1076; [2012] EWCA Civ 419, [98].

[112] *Lomas v JFB Firth Rixson Inc* [2012] 2 All ER (Comm) 1076; [2012] EWCA Civ 419, [99].

liquidation commences before or after the member club had completed its fixture commitments for the year. This is because payments by the League to member clubs during the year were not club assets until after their fixture commitments had been completed (ie at the end of the season).

Additionally, the application of the anti-deprivation rule may depend on whether the member club had defaulted on obligations to Football Creditors before it went into administration or liquidation. When the deprivation is triggered by default to Football Creditors before administration or liquidation, the rule will not apply. While the court was reluctant to express a final view on this point, it was tentatively considered that a default that occurs after the commencement of the insolvency procedure would not avoid the application of the rule.

The Interface between the Two Rules

The question of the interface, or overlap, between the two rules is important because of the different content of the rules. Plaintiffs will seek to rely on the pari passu rule whenever possible because of its strict application. For example, following the decision in *Belmont*, the appellant in *Carlton* and the plaintiff in *HMRC* argued that both rules applied. In *Carlton* the pari passu rule was relied upon in the alternative, and was the preferred basis of the plaintiff's argument, expressly because this had the advantage of putting to one side questions of commerciality and good faith.[113]

There are two issues that arise for consideration:

1) Whether the pari passu rule applies to a deprivation that occurs on bankruptcy if the recipient of the deprived asset is a creditor.
2) Whether the pari passu rule has the practical effect of rendering the anti-deprivation rule irrelevant for any deprivation that occurs after bankruptcy.

The first issue arises because it appears from *Belmont* and *HMRC* that the courts considered that the pari passu rule would apply to a deprivation occurring on bankruptcy if the recipient of the asset was also a creditor of the bankrupt. For the purposes of this discussion this will be termed the broad approach. Lord Collins said that in *Belmont* only the anti-deprivation principle was potentially applicable because the noteholders were creditors of the Issuer and not LBSF. The flip in priority did not disturb the pari passu rule as between the creditors of LBSF. Instead what was in effect being said was that the parties had unlawfully extracted an asset from LBSF (the first charge on the collateral) and passed it to noteholders.[114] This suggests that the pari passu rule would have also been at issue if the noteholders had been creditors of LBSF. The fact that Carlton was not a creditor of LBSF was also a consideration that the Court of Appeal in *Carlton* relied on in holding that the pari passu rule did not apply.[115] The Court in *HMRC* said (obiter) that if the effect of the deprivation is to distribute the asset among only some of the creditors eligible to participate in a distribution, then it is caught by both rules.[116] The clear thrust of the discussion in those cases was that it is the broad approach that would apply. The effect of the broad approach would be that the anti-deprivation rule would be rendered irrelevant for deprivations occurring on bankruptcy when the recipient is also a creditor.

If the broad approach is right, then it follows that whether the pari passu rule applies in relation to a deprivation that occurs on bankruptcy will be determined by the identity of the beneficiary of the deprivation. If the beneficiary is a creditor of the bankrupt, then the pari passu rule is engaged. If the beneficiary is not a creditor, then only the anti-deprivation rule is engaged. The determining factor is the recipient's status in the bankruptcy as creditor (or not). That does not accord with the underlying basis for the pari passu rule and contradicts the logic and rationale for the anti-deprivation rule's application to a deprivation occurring on bankruptcy.

The pari passu rule applies when the bankrupt estate is distributed other than in accordance with the statutory pari passu rules of distribution. It follows that in order for the rule to apply to the case of

[113] *Lomas v JFB Firth Rixson Inc* [2012] 2 All ER (Comm) 1076; [2012] EWCA Civ 419, [95].

[114] *Belmont Park Investments Pty Ltd v BNY Corporate Trustee Services Ltd* [2012] 1 AC 383; [2012] UKSC 38, [15] (Lord Collins).

[115] *Lomas v JFB Firth Rixson Inc* [2012] 2 All ER (Comm) 1076; [2012] EWCA Civ 419, [98].

[116] *Her Majesty's Revenue and Customs Commissioners v The Football League Ltd* [2012] EWHC 1372 (Ch), [104].

a valid deprivation on bankruptcy (ie where there is no breach of the anti-deprivation rule) then the asset validly deprived must form a part of the bankrupt estate. It is only if the deprived asset is part of the bankrupt estate, so that the statutory provisions for pari passu distribution apply to the asset, that its deprivation could be a departure from those statutory provisions so as to engage the rule. Once the deprived asset forms part of the bankrupt estate then its deprivation would mean that there had been a distribution other than on the basis of the statutory provisions for pari passu distribution. The deprived asset would have been distributed on the basis of the pre-bankruptcy contractual arrangements of the bankrupt, rather than the statutory provisions for pari passu distribution. For the pari passu rule to apply on the broad approach, it must be on the basis that a validly deprived asset is nonetheless part of the bankrupt estate if the recipient is a creditor.

There is a good argument that the pari passu rule should not apply to a deprivation occurring on bankruptcy, regardless of whether the recipient is a creditor or not, when the logic of the application of the anti-deprivation rule in *Belmont* is considered. For the purposes of this discussion this will be called the narrow approach. It is clear from *Belmont*, and confirmed in *Carlton*, that the pari passu rule does not apply to a deprivation occurring on bankruptcy when the recipient is not a creditor of the bankrupt. Logically, this can only be because an asset that is validly deprived on bankruptcy does not form a part of the bankrupt estate. For the reasons discussed above, if this were not the case then the pari passu would apply, regardless of the fact that the recipient was not a creditor. *Belmont*, in which the Supreme Court accepted that there was no issue of the application of the pari passu rule, is only explicable, therefore, on the basis that an asset validly deprived on bankruptcy does not form part of the bankrupt estate when the recipient is not a creditor.[117]

The conclusion that a validly deprived asset does not form part of the bankrupt estate gains support from the Court of Appeal in *Carlton*, which addressed the relationship between the two rules in the following terms (emphasis added):

> 96. The relationship between the anti-deprivation principle and the pari passu rule is both dependant and autonomous. The former is concerned with contractual arrangements **which have the effect of depriving the bankrupt estate of property which would otherwise have formed part of it**. The pari passu rule governs the distribution **of assets within the estate** following the event of bankruptcy. It therefore invalidates arrangements under which a creditor receives more than his proper share of the available assets or where (as in *British Eagle*) debts due to the company on liquidation were to be dealt with other than in accordance with the statutory regime.
>
> 97. The anti-deprivation principle therefore protects the value of the estate from attempts to evade the insolvency laws and, as a consequence, facilitates the application of the pari passu rule. But their areas of operation are distinct and it is clear that the pari passu rule **is only engaged in respect of assets of the estate as at the commencement of the bankruptcy or liquidation**. This was why the decisive issue in *British Eagle* was whether a debt was owed to the company when the resolution for voluntary liquidation was passed.

This also reflects Lord Mance’s statement in *Belmont* that the anti-deprivation rule governs what happens on bankruptcy, while the pari passu rule governs what happens in bankruptcy.[118] Lord Mance went on to say that if contracting out of the rule requiring pari passu distribution was impermissible, then “it would be surprising if there were no concurrent principle capable of invalidating certain dispositions which, by removing property from the bankrupt on bankruptcy, had the same ultimate effect”. In other words, the anti-deprivation principle is necessary to prevent illegitimate attempts to reduce the size of the bankrupt estate, so as to avoid the application of the pari passu rule. If the pari passu rule applied to any deprivation simply on the basis that the size of the bankrupt estate has been reduced, then the anti-deprivation rule would not be needed. It also follows that the default position,

[117] *Belmont Park Investments Pty Ltd v BNY Corporate Trustee Services Ltd* [2012] 1 AC 383; [2012] UKSC 38, [15] (Lord Collins).

[118] *Belmont Park Investments Pty Ltd v BNY Corporate Trustee Services Ltd* [2012] 1 AC 383; [2012] UKSC 38, [149] (Lord Mance).

but for the potential application of the anti-deprivation rule, is that an asset deprived on bankruptcy is not a part of the bankrupt estate, and that, as such, the pari passu rule could not apply to invalidate the deprivation.

On this approach, therefore, the only possible overlap between the rules would be in respect of deprivations occurring after, as opposed to on, bankruptcy:

- Neither rule applies to pre-bankruptcy deprivations.
- A valid deprivation on bankruptcy is not caught by the pari passu rule, because the deprived asset does not form a part of the bankrupt estate (regardless of whether the recipient is a creditor). In other words the narrow approach applies.
- Both rules apply to a deprivation after bankruptcy, though in practice it seems likely that any such deprivation would be necessarily invalidated by the pari passu rule, leaving no scope for the application of the anti-deprivation rule.

This approach has the advantage of simplicity and consistency. The broad approach qualifies the application of the pari passu rule to a deprivation on bankruptcy by reference to the status of the recipient as a creditor (or not) rather than the validity of the deprivation. If a validly deprived asset does not form a part of the bankrupt estate on bankruptcy when the recipient is not a creditor, then it is difficult to see a principled basis for holding otherwise simply because the recipient is a creditor.

The narrow approach results in a more consistent and principled approach. In applying the anti-deprivation rule the courts would give weight to the fact that a beneficiary of the deprivation was a creditor of the bankrupt. That might be a factor that weighs heavily in favour of a conclusion by the courts that the purpose of the arrangement is to avoid the application of the insolvency laws, to give the creditor a preference. The narrow approach would allow the courts to consider all of the facts against the relevant test for the application of the anti-deprivation rule, to determine whether the parties' arrangement was an illegitimate attempt to contract out of the insolvency laws. There may well be cases in which the status of the beneficiary of the deprivation as creditor should not invalidate the deprivation. For example, in *Belmont*, if the noteholders were creditors of LBSF in relation to an entirely separate and unconnected transaction, would that have provided a basis for holding that, in relation to the transaction in issue, the deprivation was invalid? If so, it could only be because the effect of the deprivation, coupled with their status as creditors of LBSF, was that they would receive more than they would have otherwise received in the bankruptcy of LBSF than if the deprivation had not occurred. While that may be so in global terms, if a validly deprived asset does not form part of the bankrupt estate, the noteholders as creditors may in fact be receiving no more than their pari passu share of the actual bankrupt estate. Any value received in respect of the deprived asset is not received as a creditor in the bankruptcy. If there was no connection between the transaction at issue in *Belmont* and the noteholders' status as creditors, to invalidate a valid deprivation would seem to be unprincipled.

The second issue, concerning the application of the rules for deprivations occurring after bankruptcy, arises because the same arguments explored above do not apply post-bankruptcy. If the deprivation of an asset occurs after bankruptcy (ie during bankruptcy), then the asset deprived would have formed a part of the bankrupt estate at the time of bankruptcy. The pari passu rules of distribution provided in the insolvency legislation applied to the deprived asset at the time of bankruptcy as it formed a part of the bankrupt estate. The deprived asset was part of the collective pool of assets available for distribution pari passu. As discussed above, that was the conclusion of the Court of Appeal in *Perpetual*. A post-bankruptcy deprivation, therefore, would have the effect of distributing the bankrupt estate other than in accordance with the statutory pari passu rules of distribution of that estate. The strict application of the pari passu rule would mean that any such deprivation would be necessarily invalid. It would seem to follow, therefore, that the pari passu rule would be necessarily engaged in such circumstances. The anti-deprivation rule would have no practical effect in respect of such deprivations because the pari passu rule applies strictly, regardless of the intention of the parties to the deprivation or the commercial reasonableness of the contractual arrangements giving rise to the deprivation.

NEW ZEALAND CASE LAW

The same principle of public policy, that parties cannot contract to avoid the application of the insolvency legislation, applies in New Zealand. There is little case law in New Zealand that considers the anti-deprivation or pari passu rules, though both rules have been applied by the New Zealand courts, following English authority. It is likely that the English case law would be persuasive authority on the scope and content of the rules. At a minimum, the New Zealand courts would have to consider the refinement of the rules in *Belmont* and subsequent cases in deciding the scope and content of the relevant principles in New Zealand law.

The anti-deprivation rule was considered in *Official Assignee v NZI Life Superannuation Nominees Ltd*.[119] In that case the Official Assignee was seeking a declaration that a clause in a superannuation trust deed, which purported to forfeit a member's benefits and rights on bankruptcy, was void in respect of the estate of two bankrupts. The Court held that it was settled law, which had not been displaced by the *Insolvency Act 1967* (NZ), that a person could not settle his or her own property so as to take under the settlement an interest defeasible on bankruptcy, as to do so would be a fraud on the bankruptcy laws. That principle was an early application of the anti-deprivation rule.[120] The Court went on to hold that, in the two cases before it, the provisions of the trust deed, and the interests created, had been authorised by regulations in force at the time that the trust deed was drafted and at the time that the two bankrupts had joined the scheme.[121] The common law principle had, therefore, been overridden by an enactment and the provisions at issue were not void. However, the common law principle would apply for any members who joined the superannuation scheme after the repeal of those regulations on 1 April 1990, because the new regulations did not have the same effect as the repealed regulations. For those later members the provision in the trust deed was rendered void as against the Official Assignee by application of the anti-deprivation rule.[122]

The pari passu rule has also been applied in New Zealand. The provision requiring pari passu distribution in company liquidations (subject to payment of preferential creditors) is s 313(2) of the *Companies Act 1993* (NZ) and there are similar provisions for bankruptcy in the *Insolvency Act 2006* (NZ). The importance of the principle of pari passu distribution was discussed by the Supreme Court recently in *Allied Concrete Ltd v Meltzer*[123] in the context of voidable transactions. It will be, accordingly, impermissible to contract out of the statutory provisions for distribution on bankruptcy on public policy grounds. That was the result in *Attorney-General v McMillan & Lockwood Ltd*[124] in which the Court of Appeal applied the pari passu rule, following *British Eagle*. The Court of Appeal held, consistent with the discussion of the rule in *Belmont* and the subsequent cases, that there was no room for balancing various public policy considerations as the pari passu rule applies absolutely on liquidation.[125] The rule was further considered in *Stotter v Ararimu Holdings Ltd*[126] in which the Court of Appeal held that it was permissible for a creditor to contract to subordinate their debt to other creditors, but it was not permissible to contract to achieve the reverse by a contract to which the other creditors were not a party. The judgment in *Stotter* also reflects the position in England and Wales.

[119] *Official Assignee v NZI Life Superannuation Nominees Ltd* [1995] 1 NZLR 684.

[120] *Official Assignee v NZI Life Superannuation Nominees Ltd* [1995] 1 NZLR 684, 690–692. The Court relied on *Higinbotham v Holme* (1812) 19 Ves Jun 88; 34 ER 451, which was applied in New Zealand in *Re Margrie* (1876) 2 NZ Jur (NS) SC 121. Lord Collins cited *Higinbotham* as an early application of the rule: *Belmont Park Investments Pty Ltd v BNY Corporate Trustee Services Ltd* [2012] 1 AC 383; [2012] UKSC 38, [2].

[121] *Official Assignee v NZI Life Superannuation Nominees Ltd* [1995] 1 NZLR 684, 692–694. The regulations were the *Superannuation Schemes Regulations 1983* (NZ).

[122] *Official Assignee v NZI Life Superannuation Nominees Ltd* [1995] 1 NZLR 684, 695.

[123] *Allied Concrete Ltd v Meltzer* [2016] 1 NZLR 141; [2015] NZSC 7.

[124] *Attorney-General v McMillan & Lockwood Ltd* [1991] 1 NZLR 53.

[125] *Attorney-General v McMillan & Lockwood Ltd* [1991] 1 NZLR 53, 61.

[126] *Stotter v Ararimu Holdings Ltd* [1994] 2 NZLR 655.

Both the anti-deprivation and pari passu rules were discussed in *Sanson v Ebert Construction Ltd*.[127] That case was an application to set aside payments and a disposition of property made just prior to the liquidation of a company (TPL) under s 292 of the *Companies Act 1993*, as insolvent transactions. TPL had contracted with the respondent (Ebert) to build an apartment complex. TPL, its senior financier (BOSI), and Ebert entered into a contract under which BOSI was obliged to pay Ebert directly, from the loan facility extended to TPL, for Ebert's work under the construction contract. Ebert's evidence was that this was a direct payment provision that was a common feature of the construction industry. Immediately prior to TPL's liquidation, BOSI made two substantial payments to Ebert under the contract. The liquidators applied to set those payments aside under s 292. The key issue for the Court was whether the payments were transactions for the purposes of s 292. However, Ebert raised as a subsidiary argument that the anti-deprivation principle was not contravened by the arrangements between the parties,[128] presumably to support the contention that the payments should not be characterised as transactions for the purposes of s 292. The Court held that there was no relevant deprivation provision at issue and, as such, the anti-deprivation rule was not relevant.[129] That conclusion was correct as the transactions in question had all predated TPL's liquidation and there was, therefore, no relevant deprivation for the purposes of the rule. Instead the Court took the view that it was the pari passu rule that was engaged in the application,[130] though that conclusion did not affect the Court's analysis of the application of s 292 to the transactions in question. In fact, the pari passu rule could not apply to the transactions in question because they pre-dated the liquidation of TPL. If the Court had concluded that s 292 did not apply to invalidate the transactions in question, then the Court could not have relied upon the pari passu rule to achieve that outcome.

CONCLUSIONS

The two rules both arise from the general principle of public policy that parties cannot contract out of the legislation governing insolvency. The two rules are aimed at different mischiefs. The anti-deprivation rule is aimed at preventing the illegitimate removal of assets from the bankrupt estate on bankruptcy. The pari passu rule is aimed at attempts by parties to contract so as to achieve a distribution of the bankrupt estate that departs from the statutory rules, to the benefit of the parties and the detriment of other creditors.

The anti-deprivation rule will not apply to all deprivations that occur on bankruptcy. The law recognises that there will be circumstances when the deprivation is not an impermissible attempt to evade the application of the insolvency laws. Leases and licences are recognised exceptions to the application of the rule. Whether a deprivation that is not a recognised exception to the rule is legitimate or not turns on an objective consideration of the purpose of the deprivation, and whether its main purpose was to avoid the application of the insolvency laws. In considering the purpose of the deprivation the courts will give weight to whether the arrangements were bona fide commercial transactions, which are commercially justifiable, and which were entered into in good faith. This approach relies upon balancing the public policy underlying the anti-deprivation rule against the public policy underlying the recognised importance of the courts giving recognition to the autonomy of contracting parties. In striking that balance Lord Collins recognised there are limits to party autonomy in the area of bankruptcy because of the interests of third-party creditors.[131] This approach gives greater importance to the autonomy of contracting parties than to the collective interests of creditors in bankruptcy.

The content of the test for the requisite intention and how it is to be applied is therefore crucial. There was agreement that the test could be satisfied when consideration of the transaction and the

[127] *Sanson v Ebert Construction Ltd* [2016] NZCCLR 11; [2015] NZHC 2402.

[128] *Sanson v Ebert Construction Ltd* [2016] NZCCLR 11; [2015] NZHC 2402, [103]

[129] *Sanson v Ebert Construction Ltd* [2016] NZCCLR 11; [2015] NZHC 2402, [112]–[113]. An appeal against this decision was argued in late November 2016, with judgment pending at the date of publication.

[130] *Sanson v Ebert Construction Ltd* [2016] NZCCLR 11; [2015] NZHC 2402, [114].

[131] *Belmont Park Investments Pty Ltd v BNY Corporate Trustee Services Ltd* [2012] 1 AC 383; [2012] UKSC 38, [103] (Lord Collins).

contractual provisions showed an objective intention to evade the insolvency laws. A subjective intention would also suffice, although was not necessary. Lord Collins also referred to the rule applying when the deprivation was "*inevitable*".[132] If bankruptcy is expressly a trigger for the deprivation in the contract between the parties, as it was in the cases considered in this article, then there would generally be a clear inference that the parties had turned their minds to the question and had agreed that the asset in question was not to remain an asset of the bankrupt on bankruptcy. Objectively, the effect of the contract is to deprive the bankrupt of an asset on bankruptcy, and objectively the parties have intended to make such a deprivation, as they have specifically provided for the deprivation to be triggered by bankruptcy. If the contract specifically provides for the deprivation to be triggered by bankruptcy, then it is also inevitable that the deprivation will occur on bankruptcy. It follows, therefore, that if the objective intention required is simply an objective intention to deprive the bankrupt of the asset in question on bankruptcy, then whenever there is a specific provision for such deprivation (which would be necessary to effect the deprivation) there will be the requisite objective intention.

However, it is clear from *Belmont* that this is not the test for objective intention. Lord Collins refers to the rule not applying to "bona fide commercial transactions which do not have as their predominant purpose, or one of their main purposes, the deprivation of the property of one the parties on bankruptcy".[133] There is a requirement for a commercial justification for the deprivation if the rule is to be avoided. As Lord Mance said, the court is considering whether the deprivation amounts to an "illegitimate evasion of the bankruptcy law or has a legitimate basis in other commercial considerations".[134] The inquiry is not, therefore, whether objectively the parties intended the result (the deprivation), but whether objectively the parties intended the deprivation for legitimate or justifiable commercial reasons other than the evasion of the application of the insolvency laws. It is possible, therefore, to have a "legitimate" evasion of the insolvency laws when there are legitimate commercial considerations for the deprivation; effectively the triumph of party autonomy over the interests of creditors. The question of whether that approach strikes the right balance is probably a question for the legislature.

The pari passu rule, unlike the anti-deprivation rule, acts strictly to invalidate arrangements that result in the distribution of any part of the bankrupt estate contrary to the statutory provisions governing distribution, in particular the principle of pari passu distribution. Because of the rule's strict application, the issue of its overlap with the anti-deprivation rule is important, but not at this stage clear.

From a practical perspective, in considering whether there has been a deprivation from the estate of a bankrupt, the following questions will be relevant:

- Which of the rules applies: the anti-deprivation rule or the pari passu rule? If the beneficiary of the deprivation is a creditor of the bankrupt, then the pari passu rule may apply. If not, and the deprivation has occurred on bankruptcy, then only the anti-deprivation rule will apply.
- What is the property that has been said to have been deprived? It may be that the bankrupt had only a limited interest that terminated on bankruptcy, paid for by executory promises that the courts are likely to hold was validly deprived. Or it may prove that the bankrupt did not have a relevant property right and, as such, there was no deprivation.
- When did the alleged deprivation occur: prior to, on, or after bankruptcy? If the deprivation occurred prior to bankruptcy, then it was not a deprivation caught by either rule. The transaction resulting in the deprivation would have to able to be set aside under the various provisions in the bankruptcy statutes (eg, as a voidable transaction in a company liquidation under s 292 of the

[132] *Belmont Park Investments Pty Ltd v BNY Corporate Trustee Services Ltd* [2012] 1 AC 383; [2012] UKSC 38, [106] (Lord Collins).

[133] *Belmont Park Investments Pty Ltd v BNY Corporate Trustee Services Ltd* [2012] 1 AC 383; [2012] UKSC 38, [104] (Lord Collins).

[134] *Belmont Park Investments Pty Ltd v BNY Corporate Trustee Services Ltd* [2012] 1 AC 383; [2012] UKSC 38, [151] (Lord Mance).

Companies Act 1993) to recover the deprived asset. If the deprivation occurred on bankruptcy, then the anti-deprivation rule applies, and if the beneficiary of the deprivation is a creditor, the pari passu rule may also apply. If the deprivation occurred after bankruptcy, then on a principled approach both rules would apply.

- What was the source of the deprived asset? If the beneficiary of the deprivation was the source of the asset, then that may be a factor favouring the conclusion there has not been a deprivation breaching the rule (providing there are legitimate commercial reasons for the deprivation).
- Are there legitimate commercial reasons for the deprivation, other than the avoidance of the application of the insolvency laws? If there are legitimate commercial reasons, then it may follow that objectively the parties did not have the requisite intention for the anti-deprivation rule to apply.

Finally, it is worth noting the fact that *Belmont* and *Carlton* were concerned with complex financial instruments and derivative transactions, underpinned by complex contractual arrangements. These facts were expressly cited by Lord Collins as important in his conclusion as to why the rule did not apply in the circumstances.[135] In less complex commercial contexts it may prove more difficult to avoid the application of the anti-deprivation rule to the deprivation of assets on bankruptcy. For example, the Court at first instance in *Mayhew v King*,[136] and the Court of Appeal on appeal in *Folgate London Market Ltd v Chaucer Insurance Plc*,[137] had no difficulty in applying the rule to invalidate a contractual provision that terminated an indemnity on the liquidation of the indemnified party. Lord Collins, in *Belmont*, said of this case that "it was a naked attempt" to avoid the application of the insolvency laws.[138]

[135] *Belmont Park Investments Pty Ltd v BNY Corporate Trustee Services Ltd* [2012] 1 AC 383; [2012] UKSC 38, [103], [108]–[109], [112] (Lord Collins).

[136] *Mayhew v King* [2010] EWHC 1121 (Ch).

[137] *Folgate London Market Ltd v Chaucer Insurance Plc* [2011] EWCA Civ 328.

[138] *Belmont Park Investments Pty Ltd v BNY Corporate Trustee Services Ltd* [2012] 1 AC 383; [2012] UKSC 38, [100] (Lord Collins).