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Why is the Anti-Deprivation Rule so Troublesome?
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It is an honour and a pleasure to be invited to give the ILA annual lecture. My focus this evening is on the anti-deprivation rule.¹ That choice is perhaps predictable to those of you who know me well, and know my fascination with the modern controversial commercial side of personal property law. And the anti-deprivation issues are certainly topical, controversial and commercially significant. By some estimates, in the Lehman Bros insolvency alone, $US8bn rides on the outcome. And yet the rule itself is poorly understood; the case law is confusing; and the issue cries out for some better analysis.

I can also claim some continuity with last year’s ILA annual lecture. When Lord Neuberger stood here a year ago,² the Court of Appeal had just delivered its judgment in Perpetual Trustee Co Ltd v BNY Corporate Trustee Services Ltd,³ one of the many cases arising out of the Lehman Bros liquidation. There, the Court of Appeal declined to strike down a priority flip clause as offending the anti-deprivation rule. The clause effectively switched secured priority over collateral away from a Lehman Brothers credit default swaps counterparty and in favour of third party noteholders (including Perpetual Trustee Co Ltd) in defined circumstances, to the detriment of the insolvent Lehman Brothers counterparty.⁴ Lord Neuberger then predicted – correctly as it turns out – that the New York bankruptcy court assessing the same facts would reach a different conclusion.⁵

These two decisions, one on each side of the Atlantic, are now being appealed, in circumstances where few practitioners seem confident or willing to predict the outcomes.

¹ This lecture revisits some of the issues discussed in ‘Insolvency Deprivation, Public Policy and Priority Flip Clauses’ (2010) International Corporate Rescue 28-39; and now also see ‘Making Sense of Arguments about the Anti-Deprivation Rule’ (2010/11) International Corporate Rescue (forthcoming).
³ [2009] EWCA Civ 1160 (CA) (‘Perpetual Trustee (CA)’), on appeal from [2009] EWHC 1912 (Ch) (‘Perpetual Trustee (HCt)’).
⁴ The court also addressed the treatment of ‘unwind costs’ between these parties, and determined the outcome of a related appeal which raised the anti-deprivation rule (Butters v BBC Worldwide Ltd).
⁵ Lehman Brothers Special Financing Inc v BNY Corporate Trustee Services Ltd Case no. 09-01242 (Bankr. SDNY) January 25 2010.
The anti-deprivation rule is stated in various ways. Put at its strongest, A cannot agree that property will be A’s until A is insolvent and then will be turned over to B.\(^6\) The clarity and certainty inherent in this simple assertion is quickly dispelled, however, by the common consensus that it is perfectly proper, and indeed common, to provide that a lease or licence in favour of A will determine on A’s insolvency. Leases of land and licences of intellectual property provide ready illustrations.

The rule has been applied by courts since at least the 18\(^{th}\) century, yet a good number of judges, including Lord Neuberger, have recognised that the line between what is permitted and what is not remains troublingly unclear. The only House of Lords authority is *British Eagle International Airlines Ltd v Compagnie Nationale Air France*,\(^7\) and that, I want to suggest to you, is a rather different case.

I think there are three reasons for the difficulties with the anti-deprivation rule. First, the rule is always described as a rule of public policy, and we are justifiably nervous about allowing judges to enter any territory labelled public policy. Secondly, we appear to be in awe of the market value – and indeed the moral value – of party autonomy and freedom of contract. And, finally, on my own personal hobbyhorse, we have somehow managed to survive, and indeed prosper, without too much rigorous analysis of our personal property principles. This is despite the fact that they play a material part in making the UK the jurisdiction of choice for many commercial parties. But, increasingly, these shortfalls are being exposed and need redressing.

All these issues were apparent in the *Perpetual Trustee* litigation, where there was noticeable judicial hesitation in intervening at all,\(^8\) with concern expressed not to extend the rule any further,\(^9\) to protect party autonomy,\(^10\) and to prefer a conclusion that the flip clause effected a permissible reduction in value rather than an impermissible deprivation of property.\(^11\)

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\(^6\) *Ex p Jay* (1880) 14 Ch D 19, 26 (Cotton LJ), cited by Lord Neuberger in *Perpetual Trustee* (CA), n. 3 above, para. 1. This is subject to the rules on protective trusts: Trustee Act 1925 s 33.

\(^7\) [1975] 1 WLR 758 (HL) (‘*British Eagle*’).

\(^8\) *Perpetual Trustee* (CA), n. 3 above, paras 54, 113, 123 and especially 171-2, all seemingly confining intervention to ‘contracting out’ provisions, although contrast paras 32 et seq and 152 et seq; also see para. 91.

\(^9\) *Perpetual Trustee* (CA), n. 3 above, para. 57.

\(^10\) *Perpetual Trustee* (CA), n. 3 above, paras 58, 91.

\(^11\) *Perpetual Trustee* (CA), n. 3 above, para. 152.
Similarly in the Australian High Court in *Ansett v IATA*\(^{12}\) – the successor to *British Eagle*, litigating the revised IATA contract – there was judicial reluctance on the part of the majority to reach a conclusion that delivered judicially inspired public policy interference to the statutory insolvency regime or which would upset the commercially successful and internationally beneficial IATA clearing house scheme.

I could give equal time to each of my three reasons for the difficulties with the anti-deprivation rule, but I think it will serve my purposes adequately if I deal with the first two in short order, and concentrate on the third.

Of course, the current crop of anti-deprivation cases also raise difficult and important cross-jurisdictional issues which complicate matters still further. I will not address these this evening, although the conflicts highlight still further the need to be able to give clear and rigorous explanations of our own rules.

So, turning to my three reasons for the difficulties with the anti-deprivation rule.

1. **Public policy**

We are, perhaps justifiably, nervous of any suggestion of judicial lawmaking by an unelected and unrepresentative minority. Indeed, although we periodically insist that equity (and the common law) are not passed the age of childbearing,\(^{13}\) we are rather more used to judges leaning in the other direction, and asserting that legal change is a matter for Parliament.

But the risk of judicial lawmaking is not material in the context of the anti-deprivation rule, despite the frequent assertions suggesting the contrary. The only public policy in play is the policy against allowing people to evade the operation of a statute. Surely there can be no complaint about this. We see the same sort of intervention in tax law issues, divorce settlements and equity’s treatment of family homes, in trade practices and competition matters, and so forth.

Indeed, it is part of my analysis that the anti-deprivation rule precisely maps – and prohibits – the only two means open to parties wishing to avoid the operation of the statute: first, parties

\(^{12}\) *International Air Transport Association v Ansett Australia Holdings Ltd* [2008] HCA 3 (Aust HCt) (‘*Ansett*’), eg paras 76-79.

\(^{13}\) Lord Denning in *Eves v Eves* [1975] 1 WLR 1338, 1341: ‘Equity is not past the age of child bearing.’
are prohibited from contracting out of the insolvency distribution rules provided by the statute. And, secondly, parties are prohibited from relying on their own insolvency as a trigger for removing assets from the distribution pool. The anti-deprivation rule neuters both escape routes, and insists that the Insolvency Act provisions are applied with full force.

So the first concern – that judges are inappropriately legislating to enforce their own perceptions of desirable public policy – ought to be dismissed in short order.

2. Sanctity of contract

The second source of difficulty with the anti-deprivation rule is its inherent conflict with party autonomy and sanctity of contract. The argument is usually framed as the death of freedom of contract. But the issue here is a conflict between two equally important public values – freedom of contract and collective sharing of insolvency losses – not the isolated death of one.

Party autonomy is, of course, relevant when construing rights and obligations arising solely between contracting parties. But on insolvency, the real issue is the rights of creditors, and no amount of self-interested desire or careful drafting will allow contracting parties to expropriate statutory insolvency rights from third parties if, at law, the mechanism offends either the rule against contracting out of the insolvency legislation or the insolvency-triggered deprivation rule.

This autonomy argument (reinforced by claims of decades of custom and practice) similarly failed to win the day in the Spectrum litigation\(^\text{14}\) when the courts had to decide whether an arrangement described by the parties as a fixed charge was, at law, a floating charge.

For the same reason, claims that the commercially significant international *lex mercatoria* of ISDA contracts should be given full rein despite the national insolvency regime cannot be right. And judicial recognition of the enormous international commercial value of the IATA clearinghouse cannot be allowed to override the rights of non-contracting third party creditors.

So sanctity of contract and party autonomy should, equally, be given short shrift. The issue for decision in anti-deprivation cases is whether the sophisticated contractual arrangements negotiated by the parties work in ways not permitted by the law so that they deny third-party creditors their legitimate rights in an insolvency distribution. And what is permitted by the law is limited to two routes: contracts which deliver proprietary rights by way of formal security; and contracts which deliver set-offs within the categories permitted by the insolvency regime (and which would in any event be delivered by the statutory regime).

3. Understanding personal property in the context of the anti-deprivation rules

But my main focus tonight is on the third difficulty, and identifying potential routes to a better understanding of the personal property issues which arise in the context of the anti-deprivation rule.

Even a casual reading of *Perpetual Trustee*, or any other modern anti-deprivation case, will confirm that a good number of issues remain unclear. For example, does it matter that the parties’ arrangement ‘was always subject to the deprivation provision’; or that the ‘preferred’ party effectively paid for the disputed benefit? It seems so, based on *Perpetual Trustee*, but the matter is not so clear if other cases are surveyed. What counts as a ‘deprivation’? What separates legitimate lease and licence determinations from illegitimate deprivation arrangements? The issues are clearly difficult; indeed, the deeper one digs into the area, the greater are the conflicts which emerge.

In an article published earlier this year I suggested one route through these (and other) difficulties. Tonight I want to revisit the headlines in that proposed approach.

The starting point is to break down the anti-deprivation rule into two component parts, reflecting the two routes which parties might pursue in avoiding the Insolvency Act distribution rules. The first rule (*the ‘contracting out’ rule*) concerns arrangements that take the insolvent’s assets as they find them, but purport to provide for a different distribution than that which would be afforded by the insolvency legislation; the second (*the ‘insolvency-triggered deprivation’ rule*) concerns arrangements triggered by insolvency that purport to deprive the insolvent of assets on which the statutory insolvency distribution rules can bite.

\[15\] N 1.
Both rules only attack agreements entered into by the insolvent. It is the insolvent who is not allowed to contract out of the insolvency legislation, or organise its affairs so as to deprive itself of property on its insolvency. There is nothing to stop the secured or the unsecured creditors agreeing with each other that the assets to which some or all of them are entitled, as a group, will be redistributed amongst themselves in some different fashion. This is the essence of subordination agreements.

Both rules only attack agreements that effect a ‘contracting out’ or a ‘deprivation triggered by insolvency’; they do not touch agreements that simply squander the insolvent’s assets in ill-advised commercial deals.

Finally, both rules only apply to prevent inappropriate insolvency distributions. They do not touch transactions and arrangements that are fully executed prior to insolvency. These transactions will stand unless they can be unwound in some other way under claw-back provisions in the insolvency legislation itself\(^{16}\) or under specific statutory, common law or equitable rules (often unrelated to insolvency) that might enable the liquidator to enhance the size of the insolvent estate.

Looking at each sub rule in turn.

**The ‘contracting out’ rule**

This is the *British Eagle* issue. It arises infrequently. The question is this: Taking the assets of the company at the time of its insolvency, are there contractual arrangements that effect a distribution of the insolvent’s estate that is different from that provided under the insolvency legislation?\(^{17}\)

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\(^{16}\) Insolvency Act 1986 (‘IA 1986’) ss 238 (transactions at an undervalue), 239 (preferences), and 245 (avoidance of certain floating charges).

\(^{17}\) The impugned arrangements may be one effecting a contractual set-off or a mini-liquidation to the advantage of some creditors when compared with the outcome that would have pertained given set-offs permitted under the insolvency legislation; or it may be an arrangement which defeats the general insolvency rules that prioritise secured creditors, prefer certain defined categories of unsecured creditors, and then generally rank remaining unsecured creditors pari passu. See *Carreras Rothmans Ltd v Freeman Mathews Treasure Ltd* [1985] Ch 207 (ChD) (‘Carreras’), at p. 226: ‘Thus the principle that I would extract from [British Eagle, n. 7] is that where 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 relevant insolvency legislation], then to that extent the contract as a matter of public policy is avoided, whether or not the contract was entered into for consideration and for bona fide commercial reasons and whether or not the contractual provision affecting that asset is expressed to take effect only on insolvency.’ (emphasis added)
In this class of case, it is irrelevant that the parties did not intend to achieve an insolvency advantage, or that the arrangement is long-standing, or has always represented the relationship between the parties, or is a static arrangement involving no insolvency trigger which changes the arrangement between the parties. All this is plain from the British Eagle case itself.\(^\text{18}\)

On the other hand, it is crucial that the company is in insolvency proceedings, and that it has assets that need to be dealt with under those proceedings. What is then important is the effect of the impugned arrangement on the treatment of the insolvent’s assets on its insolvency. If the assets have already been dealt with prior to insolvency, then the only recourse for the liquidator is the claw-back provisions under the IA 1986. This was crucial to the finding in the British Eagle case\(^\text{19}\) that transactions that had already been netted out through the IATA clearing house the previous month were safe. Similarly, this idea of proper discharge was crucial to the finding in Carreras that the debt owed by Carreras to Freeman Mathews (which was the property of Freeman Mathews) was properly discharged on the payment by Carreras into the trust account.\(^\text{20}\) As the insolvency legislation then stood, this discharge, it seems, was not able to be impugned. On the other hand, any debts due to Freeman Mathews that remained outstanding at the date of liquidation could not be dealt with under the special account arrangements; this would effect a contracting out of the IA 1986 since the arrangement would effectively prefer one creditor (the one doing Carreras’ work) over all the other creditors of Freeman Mathews.\(^\text{21}\)

Equally, if the impugned arrangement does not determine the distribution of the insolvent’s assets, but defines the very asset which is the subject of the insolvency proceedings, then the transaction is safe. This was the issue in British Eagle itself. There the majority of the House of Lords thought that the IATA arrangement determined the distribution of British Eagle’s primary assets, being the airline debts owed to British Eagle by Air France and others.\(^\text{22}\) The minority in the House of Lords, however, and all the judges in all the courts below, thought that the IATA arrangement eliminated the underlying debts between individual airlines and replaced them with the net claims against IATA.\(^\text{23}\) Accordingly, they all concluded that there was no illegitimate arrangement that effected a contracting out of the insolvency legislation;

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\(^\text{18}\) N. 7.
\(^\text{19}\) Ibid.
\(^\text{20}\) N. 17, p. 226G.
\(^\text{21}\) Ibid. pp 228G-229B.
\(^\text{22}\) British Eagle, n. 7, Lord Cross at pp 778-9. Also see Carreras, n. 17, pp 224-6.
British Eagle’s assets was simply its claim against IATA, and those would be dealt with precisely as the insolvency legislation provided. Similarly, this issue was key in the Ansett litigation before the High Court of Australia.24

On its face, this ‘contracting out’ rule has no application to the Perpetual Trustee case.

The ‘insolvency-triggered deprivation’ rule

This second rule provides that a party cannot arrange its affairs so as to deprive itself of property on its insolvency, so that it has fewer assets to distribute to its unsecured creditors. Adopting Lord Neuberger’s description from ex parte Jay, ‘there cannot be a valid contract that a man’s property shall remain his until his bankruptcy, and on the happening of that event shall go over to someone else, and be taken away from his creditors.’25

The rule is not engaged simply because parties conduct their businesses in a manner that leaves too few assets to be distributed to disappointed creditors; that is a natural risk of commercial activity.26 It is engaged only when parties agree that insolvency will trigger a deprivation of property so that the insolvent has fewer assets to distribute to its creditors. The crucial, and difficult, issue is what constitutes such an impermissible deprivation of property, and how this is distinguished from legitimate arrangements, albeit ones that leave insolvents with a shortfall for distribution.

Once again, certain issues are clear (even if they have generated some confusion in recent cases).

First, the party’s insolvency must trigger the deprivation.27 The rule does not catch arrangements which prevent property ever reaching the insolvent’s hands, as happens with

24 International Air Transport Association v Ansett Australia Holdings Ltd [2008] HCA 3 (Aust Hct) (‘Ansett’). There, by contrast with British Eagle, the majority of the High Court held that the amended IATA contract effectively defined the insolvency property of Ansett as the net claims against IATA. If this construction of the IATA contract is correct, then the conclusion that the arrangement did not effect an illegitimate contracting out of the insolvency regime clearly follows. However, the ‘if’ is important, and Kirby J’s rigorous dissenting analysis of the IATA contract is persuasive.
25 Jay, n. 6, p. 26, cited in Perpetual Trustee (CA), n. 3, para. 1.
26 And there is often nothing that creditors can complain about, but when complaints can be made, they are not rooted in this rule—they are, instead, rooted in the various claw-back and breach of duty provisions in the IA 1986.
27 And note the comments in Whitmore v Mason (1861) 2 J&H 204 (‘Whitmore’), p. 215 (Page Wood V-C) about interpreting the parties’ triggering arrangements so that parties could not evade the rule with impunity.
effective retention of title agreements and Quistclose trusts.\textsuperscript{28} Equally, deprivations caused by some other event – any other event – are not touched by this rule. In particular, deprivations caused by pre-insolvency disposal of assets,\textsuperscript{29} or by explicit deprivation or forfeiture clauses triggered by anything other than the party’s own insolvency, are all untouched by the ‘insolvency-deprivation’ rule.\textsuperscript{30} This is illustrated by the effective deprivations in cases such as Newitt (deprivation triggered by default)\textsuperscript{31} and Detmold (deprivation triggered by alienation).\textsuperscript{32} In this respect, the UK regime’s application of the anti-deprivation rule is not as broad as the US regime, at least as interpreted by Justice Peck in the Perpetual Trustee litigation.\textsuperscript{33}

If the parties have provided for a number of deprivation triggers, then the outcome – and therefore the size of the pool of assets left on insolvency – will depend upon which events are thrown up first as the debtor’s progresses through life. As the court in Perpetual Trustee recognised, there is a potential difficulty in cases where the parties purport to activate a non-insolvency deprivation trigger, but to do so after insolvency. These issues can, and should, all be subjected to more rigorous analysis.

Secondly, as with the first sub rule, this rule only concerns arrangements entered into by the insolvent, and do not touch arrangements made solely between the insolvent’s creditors.

Thirdly, it is irrelevant that the asset being ‘deprived’ was acquired by way of gift rather than for valuable consideration. It is still an asset of the insolvent, subject to all the normal insolvency distribution rules.

Forthly, for the same reason, the insolvent’s bona fides in agreeing to the deprivation arrangement are irrelevant.

\textsuperscript{28} Barclays Bank Ltd v Quistclose Investments Ltd [1970] AC 567 (HL).
\textsuperscript{29} Including encumbering assets by granting effective security over them.
\textsuperscript{30} This does not mean that the deprivation cannot be overturned, just that the means of overturning it is not the insolvency-triggered deprivation rule. Instead, the arrangement can be overturned – and the assets available to the unsecured creditors enhanced – using all the IA 1986 claw back provisions or other common law, equitable or statutory remedies.
\textsuperscript{31} Ex parte Newitt, re Garrud (1880) 16 Ch D 522 (‘Newitt’). Now, however, such a clause needs to be construed a little more carefully. Forfeiture enabling the landowner to use the chattels to complete the work may be acceptable, but a forfeiture that entitles the landowner to keep the chattels as liquidated damages may be held to be a penalty, and one that entitles the landowner to sell the chattels and retain an appropriate sum as damages may be held to be a floating charge (likely to be invalid as unregistered): see Re Cosslett (Contractors) Ltd [1998] Ch 459 (CA).
\textsuperscript{32} In re Detmold (1889) 40 Ch D 585 (‘Detmold’).
\textsuperscript{33} Lehman Brothers Special Financing Inc v BNY Corporate Trustee Services Ltd Case no. 09-01242 (Bankr. SDNY) January 25 2010.
Fifthly, it matters not that avoidance of the insolvency-triggered deprivation clause will change the commercial deal that the parties have agreed. The argument that the preferred party has ‘paid’ for the preference comes to nought if the preference is legally ineffective – that is as true of deprivation clauses as it is of security and quasi-security agreements. The anti-deprivation rule is not the only rule of law that leaves certain defendants disappointed.

Sixthly, as in the ‘contracting out’ cases, it is irrelevant that the provision was ‘always a term of the contract’. If (and this is not always an easy question) the arrangement effects an impermissible deprivation (and one that is triggered by insolvency), then the arrangement is void, and it is immaterial that it was always a term of the contract. The precedents are plain: Whitmore (deed dealing with partnership property),\textsuperscript{34} Borland (shares),\textsuperscript{35} Money Markets (shares)\textsuperscript{36} are all cases indicating that a provision which was ‘always a term of the contract’ might be held void as offending the insolvency-deprivation rule. It misses the point to argue that the party’s asset cannot pass to the liquidator except subject to the deprivation condition.\textsuperscript{37} The function of the insolvency-deprivation rule is precisely to determine whether the condition is void or effective.

But, finally, what counts as a deprivation? What arrangements, if insolvency-triggered, will offend the insolvency-deprivation rule? This is undoubtedly the difficult issue, although even here there are a number of situations that are easy to classify.

First, deprivations are assessed pragmatically. If the deprivation is on terms that assets being withdrawn from the insolvent’s estate are replaced by funds (or, presumably, other assets) of equivalent or appropriate monetary value, then the provision does not offend the insolvency-deprivation rule.\textsuperscript{38} [See both Whitmore\textsuperscript{39} and Butters (partnership assets/shares, respectively, taken at market valuation),\textsuperscript{40} Borland\textsuperscript{41} (shares taken at what the court deemed to be a ‘fair’ value).]

\textsuperscript{34} N. 27.
\textsuperscript{35} Borland’s Trustee v Steel Bros & Co Ltd [1901] 1 Ch 279 (‘Borland’).
\textsuperscript{36} Money Markets International Stockbrokers Ltd (in liq) v London Stock Exchange [2002] 1 WLR 1150 (Neuberger J) (‘Money Markets’).
\textsuperscript{37} Perpetual Trustee (HCt), n. 3, para. 45.
\textsuperscript{38} Although even this concession was not initially made: see Wilson v Greenwood (1818) 1 Sw 471, 482 (Lord Eldon LC), cited in Perpetual Trustee (CA), n. 3, at para. 32: the partnership deed provided that, on bankruptcy or insolvency, the interest of the insolvent partner should be taken by the solvent partners at valuation, and Lord Eldon thought this was nevertheless void.
\textsuperscript{39} N. 27, cited in Perpetual Trustee (CA), n. 3, by Lord Neuberger at para. 34.
\textsuperscript{40} Perpetual Trustee (CA), n. 3.
\textsuperscript{41} n. 35, pp 291-3, including an extensive discussion of whether the measure of compensation met the requirements to avoid the insolvency-deprivation rule.
Secondly, if the insolvent has an asset, and arranges that it – or any part of it – will ‘remain his until his bankruptcy, and on the happening of that event shall go over to someone else, and be taken away from his creditors’, then that offends the insolvency-deprivation rule and the arrangement is void: see Mackay (royalties), [Jay (builder’s chattels), Detmold (marriage settlement), Oystertec (patents)]. From this follows the well-recognised rule that parties cannot set up protective trusts of their own property in favour of themselves.

On the other hand, and thirdly, if the arrangement is such that the insolvent receives and only ever holds the asset subject to a deprivation limitation, then the deprivation question is considerably more difficult. For example, leases or licences determinable on the lessee’s or licensee’s insolvency are exceedingly common and undoubtedly valid. By contrast, other similarly worded deprivation arrangements are void: Whitmore (partnership property), Borland (shares), Money Markets (shares), and Oystertec (patents) all illustrate potentially void insolvency-triggered deprivation provisions that had always been part of the parties’ agreement. What divides these two types of cases? And where does the Perpetual Trustee priority flip clause fall?

Cases and commentary often suggest that the divide tracks the distinction between impermissible conditional interests (‘but if’ the person becomes insolvent), and permissible determinable interests (‘until’ the person becomes insolvent). If breach of the insolvency-deprivation rule hangs on the form of words used, so that ‘but if’ offends public policy whilst ‘until’ does not, even though both might relate to the same underlying asset and impose the same insolvency limitation, then there is certainly something seriously wrong with the law. But the crucial distinction, it seems, is not rooted simply in language.

43 Ex parte Mackay, re Jeavons (1873) LR 8 Ch App 643 (‘Mackay’).
44 N. 6.
45 N. 32.
46 Fraser v Oystertec plc [2003] EWHC 2787 (Ch) (‘Oystertec’). This conclusion is not, it seems, touched by Lord Neuberger’s suggestion in Perpetual Trustee that parts of the Oystertec decision must be deemed overruled: n. 3, para. 74.
47 Re Brewer’s Settlement [1896] 2 Ch 503. This is so even though protective trusts (of income) are allowed under the Trustee Act 1925 s 33, and that provision does not explicitly deny a settlor the ability to do this with his own property; s 33(3) merely preserves the general law rules in respect of invalidity. On the other hand, an insolvent can of course be the beneficiary of a protective trust (of income) which has been set up by others over property that they then owned.
48 See Perpetual Trustee (CA), n. 3, paras 64, 81, 143-6.
49 All cited earlier.
50 Eg Re Kings’ Trusts (1892) 29 LR Ir 401, 410 per Porter MR (‘little short of disgraceful to our jurisprudence’); Re Sharp’s ST [1973] Ch 331, 340; Re Trusts of the Scientific Pension Plan [1999] Ch 53, 59 (Rattee J); Money Markets, n. 36, para. 87.
It is notable that the cases themselves do not mechanically classify interests as either conditional or determinable. Instead, they hold a line between capital and income interests (roughly speaking), with the former not able to be limited or made subject to insolvency-deprivation provisions, and the latter able to be made subject to them.\(^{51}\) The statutory protective trust repeats this division, and protects only the income rights of beneficiaries.\(^{52}\)

This clearly acknowledged capital/income distinction is instructive, and intuitively attractive, yet it too provides a dividing line that is hardly robust enough to carry the burden of a rigorous application of the insolvency-deprivation rule.

A clearer and more certain rule is needed when the conflicting rights of innocent creditors hang in the balance. I have suggested an option that is, I think, supported by all the cases, although not expressly articulated by them. It is this. If the proprietary interest in question can *only* and must *necessarily* be defined in a time-limited way, then it is legitimate to define the time limitation in any way the parties choose, including by reference to the insolvency of the interest-holder. Leases, licences, rights to interest payments and dividend payments, rights to income and annuities all fall into this category. I like to think that Lord Neuberger was pursuing this idea when he talked of the exceptional cases where the asset is ‘inherently determinable’\(^{53}\).

\(^{51}\) Starting from *Brandon v Robinson* (1811) 18 Ves 429. See, eg, *Re Smith* [1916] 1 Ch 369, especially p. 374 (Sargant J), where a clause worded as a forfeiture clause and using ‘if…then…’ language was held to be void for repugnancy, but essentially on the ground that the capital aspects could not be severed from the income aspects, with the implication that the outcome might have been different, despite being worded as a condition subsequent, if the assets had been exclusively income assets. Similarly, in *Re Trusts of the Scientific Pension Plan* [1999] Ch 53, at pp 59-63 (Rattee J), where a clause which provided that all rights to an annuity would be ‘forfeited’ on bankruptcy was held effective, but it was seen as significant that the annuity was an income right, not a right to a capital sum or to an absolute or life interest in capital, and so *Smith* (above) and the Australian case of *Caboche v Ramsay* (1993) 119 ALR 215 were both distinguished. *Re Leach* [1912] 2 Ch 422 (income limited ‘until …’ held valid). *Re Forder* [1927] 2 Ch 291 (CA), especially p. 311 (Sargant LJ), where a forfeiture clause was held not void for repugnancy because it was limited to income interests arising before the beneficiary was entitled to an absolute interest in the capital (so, again, enabling the case to be distinguished from *Smith*, above).

\(^{52}\) See Trustee Act 1925 s 33. More generally in this area, the focus on public policy / repugnancy rationales, not on form over substance, is reinforced by the treatment of interests arising under trusts. The famous flexibility of trusts is ignored, and indeed the courts simply ‘look through’ the trust structure, and reach the same conclusions as would have been reached if the underlying asset had been held directly at law: see Lord Eldon in *Brandon v Robinson* (1811) 18 Ves 429, 434. Some commentators suggest this was part of Lord Eldon’s objective to assimilate equity and law (eg Alexander, (1985) 37 Stanford LR 1189, 1199, cited in G Moffatt, *Trusts Law: Text and Materials* (4th edn, CUP, Cambridge, 2005), p. 258). This may have been a motivation, but neither public policy nor repugnancy concerns could have been addressed if trust devices were allowed to operate as shrouds over the underlying dispositions or deprivations.

\(^{53}\) *Money Markets*, n. 36, para. [37].
By contrast, with all other proprietary rights, the insertion of a time limitation effects a forfeiture; it does not simply define the term of the interest. In this category are houses, shares, patents, debts, royalties, and so on. In this category, if a time limitation is inserted, and if it is triggered by the right-holder’s insolvency, then the limitation is void.\textsuperscript{54} It will be regarded as designed to ensure that the asset – or some part of it – will ‘remain [the insolvent’s] until his bankruptcy, and on the happening of that event shall go over to someone else, and be taken away from his creditors.’\textsuperscript{55} This offends the insolvency-deprivation rule, and the arrangement is void. The courts can run a blue pencil though the provision.

Applying this analysis to the facts in \textit{Perpetual Trustee}, the insolvency-deprivation rule would render the priority flip clause void if, and only if, the clause is triggered by LBSF’s insolvency and the flip constitutes a deprivation. Here it seems the flip was triggered earlier, and not by LBSF’s insolvency.\textsuperscript{56} This would immediately mean that the insolvency-deprivation rule had no application.

If the flip had been triggered by LBSF’s insolvency, then the second issue becomes material. Is a priority flip a deprivation? Note that the question is not whether the \textit{Issuer} can offer security over its assets in a way that prioritises one secured creditor (LBSF, the first chargee) in some circumstances and a second chargee (Perpetual Trustee) in other circumstances. The right question is, does the priority flip effect a deprivation of LBSF’s assets?

Put another way, is a charge (or a secured debt) only and necessarily time-limited (ie, in the same category as leases, licences and the like), or not (ie, in the same category as shares, patents and the like)? Lord Neuberger tentatively opted for the former.\textsuperscript{57} If the preceding analysis is accurate, this might not be right.

\textbf{Conclusion}

So now I’ve almost reached the end. You can, I hope, see that matters are difficult. And good number of those difficulties are rooted an imperfect understanding of our personal

\textsuperscript{54} Eg, many assets can be made subject to contractual forfeiture provisions, or can be held under trusts in ways that define different parties’ interests along a time line. These arrangements can sometimes be overturned outside insolvency (see, eg, the rules on forfeiture), but will invariably be held void if the forfeiture or deprivation trigger is the right-holder’s insolvency. These arrangements breach the insolvency-triggered deprivation rule.

\textsuperscript{55} \textit{Jay}, n. 6, at p. 26 (Cotton LJ).

\textsuperscript{56} This is not absolutely clear from the judgment, and may merit further investigation given its potential significance to the outcome – see \textit{Perpetual Trustee} (HCt), n. 3 above, paras 52-55, especially para. 52. \textit{Perpetual Trustee} (CA), n. 3, paras 62, 64, 137.
property rules. Academics, myself included, are not immune from this imperfect understanding. Despite the years of ‘doing’ British Eagle with my undergraduates, it’s clear I’d hardly touched the surface of the problems it sought to address. That didn’t happen until the careful judgments in Money Markets and Perpetual Trustee forced the questions.

Now, having given the matter little more thought, I want to suggest that one workable route through these difficult cases is to recognise that there are two distinct and distinctive anti-deprivation sub-rules in play. There is a ‘contracting out’ sub-rule. This prohibits arrangements which provide for a distribution of the insolvent’s assets that differs from the distribution that would be delivered by the IA 1986. There is also an ‘insolvency-triggered deprivation’ sub-rule. This is a rule which prohibits insolvency-triggered arrangements that deprive the insolvent of assets available for distribution on insolvency.

In assessing whether particular arrangements offend either of these rules, it is completely irrelevant that party autonomy may be overridden, that there was no intention to offend insolvency rules, that the arrangements between the parties were always subject to the provisions in question, or that the preferred parties effectively paid for the preferential benefits delivered by the provisions. In addition, in relation to the ‘contracting out’ rule, it is also irrelevant that there is no insolvency trigger (and maybe no trigger at all). And, finally, in relation to the ‘insolvency-triggered deprivation’ rule, the commonly cited distinction between conditional and determinable interests is not the underlying discriminator in deciding whether an arrangement delivers an unacceptable deprivation. Rather, the distinction is between proprietary interests which can only and necessarily be defined in a time-limited way, and all other cases where interests need not be so defined. In the former category, the time limitation can be defined in any way the parties choose, including by reference to the insolvency of the interest-holder; in the latter category, any insolvency-triggered time-limitation will offend the insolvency-deprivation rule and the arrangement will be void.

So that is it. In reaching this point I am acutely aware that I have in my audience this evening many of you who are my inspiration – my footnotes, in academic terms – and I do hope you will excuse the absence of footnote references to each of you in what I have said, and will be gentle afterwards in explaining where I am mistaken or confused.

May I close by very warmly thanking the Insolvency Lawyers Association and its members for their continuing ability to demand simple answers to questions that turn out to be quite complicated. I’ve been associated in one way or another with the ILA for 15 years, almost
since the time I arrived in the UK, and have found it inspiring and challenging – and of course it hosts wonderful parties!

Thank you all for your attention tonight.