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A FALCON TAKES FLIGHT: THE ANTI-DEPRIVATION PRINCIPLE AND CORPORATE GROUPS

Peregrine Investments Holdings v. A.I.F.M.C. Ltd. LDC

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I. INTRODUCTION

There is a well-known principle in insolvency law that prohibits an insolvent debtor from providing contractually or otherwise that his property or rights will be confiscated or pass on to another upon his insolvency. The "anti-deprivation" principle, as it has come to be known by some,[1] is said to be a reflection of public policy in the administration and distribution of an insolvent's estate seeking to prevent a "fraud" on insolvency law. The important case of *British Eagle v. Air France*[2] appeared to offer a distributive justification for this grounded in *pari passu* distribution, avoiding provisions that sought to unfairly confer priority on a particular creditor to the prejudice of the unsecured creditors of an insolvent company. Much scholarly debate and case law has since ensued on the proper scope and rationale for the principle, with one judge expressly finding it difficult to "discern any consistent approach in the authorities as to the application of the principle."[3]

In a separate vein, groups of companies also pose various unique issues for insolvency law. These generally concern the protection of group creditors and fair treatment of claims in the liquidation of an insolvent group, or specific companies within that group.[4] There is often a tension between the fair treatment of various constituencies of creditors and the stringency of the separate legal entity doctrine established in *Salomon v. Salomon Co.*,[5] as applied to corporate group structures.

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1 The term appears to have been first coined in the headnote of *Money Markets International Stockbrokers Ltd. (In liq.) v. London Stock Exchange Ltd.* [2002] 1 W.L.R. 1150 [*Money Markets*], and was subsequently adopted in *Peregrine Investments v. AIFMC Ltd. LDC*, *infra* note 6.

2 [1975] 2 All E.R. 390.

3 *Money Markets*, *supra* note 1 at para. 87, per Neuberger J.

4 See generally Vanessa Finch, *Corporate Insolvency Law: Perspectives and Principles* (Cambridge: Cambridge University Press, 2002), c. 12 at 406-418; James O'Donovan, "Grouped Therapies for Group Insolvencies", in Michael Gillooly ed., *The Law Relating to Corporate Groups* (Sydney: Federation Press, 1993) at 46-90.

5 [1897] A.C. 22.

For the first time, these two sets of issues were brought to a head in *Peregrine Investments Holdings v. A.I.F.M.C. Ltd. LDC*[6] ('*Peregrine*'), a decision of the Hong Kong Court of Appeal. It held that the principle extended beyond the contracts and property of an insolvent parent company placed in winding-up, to prevent the deprivation of property held by its subsidiaries. This note seeks to evaluate the implications of the decision in *Peregrine* on the development of the anti-deprivation principle generally and, in particular, its application to insolvent corporate groups.

II. The Judgments in *Peregrine*

A. *The Facts in Summary*

Peregrine Investment Holdings Ltd. ('PIH') was the Bermuda parent of a large conglomerate of some 250 companies operating primarily out of Hong Kong in the business of merchant and investment banking. The group was organized into five sectors—securities, corporate finance, fixed income, fund management and direct investment—and PIH served as group treasurer. Peregrine Infrastructure Investments ('PII') was one of PIH's direct investment subsidiaries. It was a British Virgin Islands company wholly-owned by Peregrine Venture Capital Limited ('PVC'), which was in turn wholly-owned by PIH.

In 1993, PIH sought to set up an infrastructure-related fund for the purpose of achieving long term capital appreciation. Together with various advisors and investors, PIH incorporated the Asian Infrastructure Fund ('AI Fund') in the Cayman Islands on 9 November 1993. This fund was to be managed by the Asian Infrastructure Fund Management Company Limited, LDC ('AIFMC'), also incorporated in the Cayman Islands on 15 March 1994. The Fund Shareholders Agreement ('FSA'), an agreement made between the AI Fund, PIH, Frank Russell Company (as co-sponsors of the AI Fund) and the other AI Fund shareholders with respect to the AI Fund, was executed on 28 October 1994 and provided for an initial capital commitment of US$250 million. In accordance with the investors' Placement Memorandum, AIFMC was to have sole investment discretion over the AI Fund. PII held a 4% stake in the AI Fund, and a 31.5% shareholding stake in AIFMC. There were five other shareholders in AIFMC, some of whom also held shares in the AI Fund. The par value of PII's shares in AIFMC was US$3,150.

Subsequent to the AI Fund venture, PIH encountered serious financial difficulties in the midst of the Asian financial crisis. On 13 January 1998, a petition to wind up PIH was presented in Hong Kong and liquidators were appointed.[7] A dispute emerged between the liquidators of PIH and the other AIFMC shareholders (apart from PII) over the transfer of AIFMC shares pursuant to the provisions of the Management Shareholder's Agreement ('MSA'), made between AIFMC, PII and the other AIFMC shareholders on 28 October 1994. PIH was not a party to the MSA, although it was a party to the FSA. This dispute centred on clause 14 of the MSA, which provided for the involuntary transfer of AIFMC shares under certain circumstances. Clause 14.2

6 [2004] HKEC 54 (Court of Appeal, Hong Kong), Civil Appeal No. 32 of 2003, 13 January 2004.

7 A winding up petition was also presented in Bermuda on 19 January 1998.

and 14.3 stated:

> 14.2 If a Shareholder ("the Defaulting Shareholder") and/or any affiliate[8] thereof which is a party to the Fund Shareholders Agreement:
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> > 14.2.1 commits a material breach of its obligations under this Agreement and/or under the Fund Shareholders Agreement;
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> > 14.2.2 makes an assignment for the benefit of creditors generally or fails to pay its debts generally as they become due; or
> >
> > 14.2.3 suffers any distress …; or *a petition is presented or an order is made or a resolution is passed for the winding-up of the Defaulting Shareholder or such Affiliate*;
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> then any of the other Shareholders (a "Non-Defaulting Shareholder") may serve a notice in writing (a "Default Notice") to the Defaulting Shareholder. The Default Notice shall unconditionally constitute the Company [AIFMC] as the agent of the Defaulting Shareholder for the sale of the Sale Shares as defined below in accordance with the provisions of this clause.
>
> 14.3 Within 30 days of receipt of a Default Notice the Company shall make an offer to the Non-Defaulting Shareholders by notice in writing (the "Transfer Notice") to sell to the Non-Defaulting Shareholders pro rata to their Commitments the Shares of the Defaulting Shareholder and any Affiliate of the Defaulting Shareholder *at the par value* thereof …[9]

One of AIFMC's shareholders, SFM Advisory Holdings LP, served a default notice under clause 14.2 on PII based on PIH's winding-up and in respect of PII's shares in AIFMC ('the AIFMC shares'). On 5 February 1998, AIFMC duly issued the transfer notice to the other shareholders offering the AIFMC shares at par value in accordance with clause 14.3.

On 9 February 1998, PIH's provisional liquidators notified AIFMC that they would challenge any attempt to transfer the AIFMC shares. Notwithstanding this, the shares were transferred to the remaining AIFMC shareholders at par. It was conceded by the AIFMC shareholders that their actual value was "significantly higher" than this.[10] PIH's liquidators brought an action seeking a declaration that the relevant provisions of clause 14 of the MSA and the purported transfer of PII's AIFMC shares were void and *of no effect*. They sought to achieve this using two devices—the avoidance of dispositions of an insolvent company's property under section 182 of the Hong Kong *Companies Ordinance* and the anti-deprivation principle.[11]

B. *The Principal Reasoning in* Peregrine

At first instance, Yuen J. found in favour of the plaintiffs by applying the anti-deprivation principle.[12] She reasoned that the transfer of the AIFMC shares pursuant

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[8] "Affiliate" was defined in the FSA as a subsidiary or holding company: *supra* note 6 at para. 51(a).

[9] [Emphasis supplied].

[10] This was conceded by the defendants/appellants to be significantly lower than the "fair value" of the AIFMC shares: see *supra* note 6 at para. 111, *infra* note 12 at para. 155.

[11] The liquidators also alleged a conspiracy, but this aspect of the case is beyond the scope of this note.

[12] Reported at [2003] 1 HKC 455 (Court of First Instance, Hong Kong).

to clause 14 was not a fair realisation of a 'free-standing' asset of PII for proper value. Value was removed from the shares in AIFMC held by PII as these were transferred from PII at par value when their actual value was significantly higher.[13] Notwithstanding that the AIFMC shares were not held by PII on a bare trust for PIH,[14] but beneficially owned by PII, she held that the anti-deprivation principle applied to avoid the transfer even though only PIH was placed in winding up. Clause 14 of the MSA's *effect* in stripping economic value from PIH's shares in PII, via PVC, was sufficient to invoke the principle. This transposition of the principle from the AIFMC shares to PIH's shareholding in PII via PVC was supported by the policy underlying the principle to protect the insolvent's assets for its general creditors and the fact that a loss caused to a subsidiary is considered, at common law, a loss caused to its parent company.[15]

The unsuccessful shareholders of AIFMC brought this issue to the Hong Kong Court of Appeal, which was divided on the matter. The majority, Rogers and Woo VPP., held that the principle extended to a situation where *value* was extracted from the insolvent company to the detriment of its creditors, even if notional property rights were not removed. Thus the anti-deprivation principle avoided clause 14 of the MSA as it prevented PIH from realising the true value it held in PII as a subsidiary.

Cheung J.A. disagreed. He thought that the anti-deprivation principle should not apply to contracts not entered into by the insolvent, nor those that did not concern its assets. Despite the broad statements of principle in both *Higinbotham v. Holme*[16] and *Re Jeavons, ex parte MacKay*,[17] they "were not propounding a free-standing principle which would apply whenever the property of a bankrupt is affected as a result of his bankruptcy irrespective of whether the bankrupt has made the arrangement himself or not."[18] To so hold would in effect be abrogating the separate entity doctrine re-emphasised by *Adams v. Cape Industries Plc.*[19] in the context of corporate groups.

III. The Anti-Deprivation Principle in *Peregrine*

In rendering clause 14 and the resultant transfer of AIFMC shares void, the *Peregrine* litigation raises two important questions on the scope of the anti-deprivation principle. First, what reach does the principle have over the assets of a company in winding up proceedings? It seems to follow from the reasoning in *Peregrine* that the principle

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[13] Citing *Borland's Trustee v. Steel Brothers & Co Ltd.* [1901] 1 Ch. 279 [*Borland's Trustee*]; *Re Frechette*; *Daoust v. Compagnie De Geston Gar-Vin Inc. et al.* (1982) 138 D.L.R. (3d) 61 (Quebec S.C.) [*Re Frechette*] and *Canadian Imperial Bank of Commerce v. Bramalea Inc*. (1995) 33 O.R. (3d) 692 (Ontario Court of Justice) [*Bramalea*].

[14] This precluded the avoidance of the transfer as a void disposition under s. 182 of the Hong Kong *Companies Ordinance*, Cap. 32 [*HKCO*].

[15] *Ibid.* at paras. 159-162, citing *George Fisher (Great Britain) Ltd. v. Multi Construction Ltd.* [1995] 1 B.C.L.C. 260 and *Geber Technology Inc. v. Lectra Systems Ltd.* [1997] R.P.C. 443 at 477. It need only be pointed out here that the analogy drawn is inexact. In these two cases, the measurement of loss encompassing loss to subsidiary companies was an assessment consequent to a breach of a direct obligation owed to the parent company, whereas on the facts of *Peregrine*, no such direct contractual or tortuous obligation was asserted. PIH was not a party to the relevant MSA.

[16] (1812) 19 Ves. Jr. 88; 34 E.R. 451.

[17] (1873) 8 L.R. Ch. App. 643.

[18] *Supra* note 6 at para. 149.

[19] [1990] 1 Ch. 433 at 536.

extends beyond the immediate company placed in winding up, to prevent (at least) the transfer of assets held by that company's wholly-owned subsidiaries whenever such a company is deprived of the *economic value* of assets held by its subsidiaries to the detriment of its creditors. This raises a second question: to what extent does the principle interfere with contractual provisions that come within its rationale? Does it only interfere with the enforcement rights of the contractual counterparty?[20] Or does it also render such contractual rights void, depriving the counterparty of the benefit of the contractual provisions entirely? I propose to examine the second question first and then consider how it might influence the outcome on the first.

A. *The Effect of the Principle on Pre-insolvency Contractual Rights*

The answer to this question depends on what rationale one attributes to the anti-deprivation principle. Mokal argues that the cases applying the principle only support a policy of mandatory collectivity in insolvency proceedings, and do not represent an insolvency ideal of formal equality amongst creditors of the insolvent.[21] Quite the opposite— insolvency law respects pre-insolvency rights and entitlements, and interferes with these only when they purport to confer immunity on a particular creditor from the collective authority given to the relevant officer in charge of the insolvency proceedings. If the anti-deprivation principle is indeed solely an expression of the wield of collectivity, it would follow that the principle should only abrogate or interfere with rights that undermine that collectivity, and no more. Thus, on the facts of *ex parte Mackay*,[22] the principle would prevent the creditor from unilaterally conferring immunity on himself by inflating his security rights at the advent of bankruptcy proceedings, without otherwise undermining the value of his unsecured claim against the estate.[23]

In contrast to this collective "procedural" emphasis, the decision in *British Eagle v. Air France* points to a substantive or redistributive rationale based on fairness to creditors of an insolvent. The House of Lords rendered the provisions of the International Air Transport Association ('IATA') clearing house agreement unenforceable against British Eagle from the moment voluntary winding up proceedings commenced, on the basis that the agreement purported to confer an advantage on the members of IATA, who were also creditors of British Eagle, that was akin to a security interest when these members had not provided public notice of the existence and effect of the IATA clearing house provisions.[24] In consequence, not only were airline creditors prevented from enforcing the provisions of the agreement during British Eagle's winding up, they lost the quasi-security value of those contractual set-off rights as well.

Although the judgments in *Peregrine* are not completely clear as to the precise extent to which clause 14 was rendered unenforceable, it is submitted that *Peregrine*

[20] On the facts of *Peregrine*, the right to have the AIFMC shares transferred in accordance with the terms of clause 14 of the MSA.

[21] Rizwaan Mokal, "Priority as Pathology: The *Pari Passu* Myth" [2001] Cambridge L.J. 581

[22] *Supra* note 17.

[23] Thomas Jackson, *The Logic and Limits of Bankruptcy Law* (Cambridge, Mass.: Harvard University Press, 1986) [Jackson, *Bankruptcy Law*] at 27-29, 40-44, 101-104, argues that such a policy should only limit the enforcement rights of a claimant, and not the relative value of the claim. The latter should be vindicated by a substitute secured claim or proof of the claim in the insolvency proceedings.

[24] *Supra* note 2 at 410, per Lord Cross.

appears to take the principle along this second path. Assume for the moment that PII was also placed in winding up. The mere transfer of AIFMC shares in accordance with clause 14 would allow the other AIFMC shareholders to ignore the collective process mandated by a winding up to realize and distribute PII's assets. In accordance with the collectivist view, the anti-deprivation principle would render the transfer void, allowing the AIFMC shares to be restored to the insolvent estate. These shareholders would then be left with their remedy to prove for their claim for breach of clause 14 and rank *pari passu* with all other unsecured creditors. The MSA did not otherwise confer any security for the performance of PII's obligations under clause 14.

However, this could not have been a satisfactory result for the creditors of PIH on the facts. The courts in *Peregrine* did not collapse the corporate structures of PIH, PVC and PII. It follows that a hierarchy of creditors' claims would exist between PIH and PII. The non-defaulting AIFMC shareholders would, as creditors of PII, be entitled to priority over the creditors of PIH, who only stand in the shoes of PIH as a parent shareholder. PIH's creditors would still be deprived of the pre-insolvency value in the PII shares to the extent that the value of the non-defaulting AIFMC shareholders' claim for breach of clause 14 is recognised. It follows that in rendering clause 14 void, the court probably intended that all primary and secondary obligations associated with clause 14 were wholly unenforceable. Yuen J. thus held that as "cl. 14 had the effect of depriving an insolvent company of the *value of its property* on insolvency to the detriment of its creditors … public policy requires that it be declared void."[25] The majority adopted a similar formulation.[26] The principle thus prevented the AIFMC shareholders from realizing the value of the 'bargain' offered by clause 14 in the event of PIH's winding up.

This inference is reinforced by the approval given at first instance and on appeal to two Canadian decisions. In *Re Frechette*,[27] the Quebec Superior Court held that a shareholders' agreement, insofar as it provided that upon the bankruptcy of any of the shareholders, the other shareholders would be given a right to purchase his shares at 80% of the value fixed by a formula for setting the price in a voluntary sale, was unenforceable. Meyer J. held:

> … the court is also of the view that the final paragraph of art. 1 of the agreement, Ex. R-2, would be null and void and not opposable to the trustee in bankruptcy as being contrary to public policy for the reasons stated by Farwell J. in the decision [*Borland's Trustee v. Steel*] just referred to, i.e., *the granting of a special reduction in the price to be paid by the remaining shareholders for the shares of one of their number in the event of his bankruptcy, as compared with the price to be paid by them for these shares in any other eventuality*. Although the clause would be perfectly valid were such a difference in price not provided for, it is obviously *unconscionable that the trustee of a bankrupt shareholder should receive less than*

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[25] *Supra* note 12 at para. 162; and not merely the right to control the realisation of its assets. See also the declaratory order granted by Yuen J., *supra* note 6 at para. 69: "(1) Clause 14 of the Managers Shareholders' Agreement dated 28 October 1994 entered into amongst the 2nd plaintiff and the 1st to 6th defendants is void *and of no effect* insofar as it purports to allow the defendants to transfer the Shares at par value by virtue of the presentation of the winding up petition or the making of a winding up order against the 1st plaintiff…" [emphasis added].

[26] See *infra* note 46 and accompanying text.

[27] *Supra* note 13.

> *the true value of the shares, while under other circumstances the actual value is payable*.[28]

In *Canadian Imperial Bank of Commerce v. Bramalea Inc.*,[29] a partnership agreement that allowed the remaining partners to purchase a bankrupt partner's shares, in the event of his insolvency, at a price below market value was void. The court accepted that a contractual provision which removes value from the "reach of the insolvent person's creditors" upon insolvency and "places that value in the hands of others" via a sale at an undervalue, is void and unenforceable.[30]

It is submitted that *Peregrine* and these prior cases represent a second dimension of the anti-deprivation principle which not only precludes contractual attempts to gain immunity from collective insolvency proceedings, but goes further to avoid contracts that deprive the insolvent estate of value. What justifies this departure from absolute priority? To answer this, recourse may be had to the normative distinction between insolvency rules that enforce collectivity and those that police debtor misbehaviour.[31] In accordance with this distinction, the decision in *Peregrine* ostensibly sought to address some form of corporate debtor misbehaviour on the part of PII in contracting clause 14, and not merely to preserve collectivity in winding up.

The concern is not so much that the non-defaulting AIFMC shareholders are arrogating immunity from collectivity for themselves, but are *in addition* taking advantage of improper conduct on the part of PII in contracting for clause 14. It is submitted that the deprivation of value is improper, and therefore unenforceable, because of the unacceptable agency costs involved in the negotiation of such provisions. A close, though inexact, analogy may be drawn with the avoidance of transactions at an undervalue.[32] There, the underlying rationale has been articulated as an attempt to ameliorate the perverse incentives of the debtor's management in circumstances where the company is insolvent or would be rendered insolvent as a result of the transaction in question.[33] As management and the shareholder interests it represents do not directly bear the costs of their decision by virtue of limited liability, the law is concerned to ensure that creditor interests are not unfairly sacrificed by this moral hazard. Thus transactions that exhibit a significant undervalue in terms of the consideration provided by third parties *vis-à-vis* the consideration provided

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[28] *Ibid*. at para. 17 [emphasis supplied]. The substantive effect of the principle was recognised in *Re Malka* (1990) 1 C.B.R (3d) 305 at para. 38-39, per Halperin J.: "A closer examination of this decision, however, reveals an important qualification, namely, that the Court refused to oblige the trustee to respect the discounted purchase price at which the co-shareholders could acquire the shares."

[29] *Supra* note 13.

[30] *Ibid.* at paras. 6-8, per Blair J., citing Farewell J. in *Borland's Trustee*, *supra* note 13 at 291.

[31] See Thomas Jackson, "Avoiding Powers in Bankruptcy" (1984) 36 Stan. L. Rev. 725 at 786, who distinguishes preferences and fraudulent conveyances in U.S. bankruptcy law on the basis that preference law promotes the mandatory collective policy of insolvency proceedings vis-à-vis creditors *inter* se by ensuring that creditors do not preempt collective realization of the assets of the insolvent, while fraudulent conveyance law focuses on the behaviour of the insolvent debtor vis-à-vis creditors that improperly transfers value in the estate to third parties to the detriment of creditors collectively.

[32] For an example in Singapore law, see *Bankruptcy Act* (Cap 20, 1995 Rev. Ed. Sing.), s. 98 [*BA*], imported into winding up via *Companies Act* (Cap 50, 1994 Rev Ed. Sing.), s. 329.

[33] See Dan Prentice, "The Effect of Insolvency on Pre-Liquidation Transactions" in B.G. Pettet ed., *Company Law in Change* (London: Stevens, 1987) at 75-78; John Armour, "Transactions at an Undervalue" in John Armour & Howard Bennett eds., *Vulnerable Transactions in Corporate Insolvency Law* (Oxford: Hart, 2003), c. 2 at 46-47.

by the debtor are subject to the discretionary jurisdiction of the court to correct the improper dissipation of value from the insolvent company.[34]

In the case of *Peregrine*, it was anticipated by the parties to the MSA that clause 14.2.3 would be triggered, *inter alia*, upon the winding up of themselves or their respective affiliates.[35] It was undisputed that the involuntary transfer at par value was significantly below the fair value payable for the voluntary transfer of the AIFMC shares measured in accordance with clause 9.2.1 of the MSA.[36] These markedly different consequences, dependent on the financial condition or institution of insolvency proceedings against PII or its affiliate, raise considerable suspicion. The management of companies in such situations are offering a consideration that imposes no direct costs on them, since the costs of accepting the clause are borne solely by the residual claimants of the insolvent company—its unsecured creditors—while the benefits are likely to be enjoyed only when PII is solvent and some other AIFMC shareholder defaults.[37] Secondly, a behavioural analysis adds to the concern over proper managerial judgment in negotiating for such clauses since management is likely to inaccurately assess the probability and costs of such future events of default.[38] Thirdly, further undervaluing of the costs of such a clause occurs because the debtor is under no obligation to disclose it to the other creditors of the debtor.[39]

To counteract perverse incentives and undervaluing that result in a disproportionate imposition of costs on unsecured creditors of the company (which are unlikely to be compensated *ex ante*), such anticipatory forfeiture clauses like clause 14 should be completely unenforceable even though the company may not contemporaneously be insolvent or close to insolvency at the time of the transaction.[40] The inherent flaws in the decisional matrix surrounding negotiations over such clauses, signaled by the lack of substantial or adequate consideration, justifies insolvency law's avoidance of the contractual provision. Both these considerations were alluded to in *Re Frechette*:

> 18 It may be true that the discount of 20 per cent provided for by the shareholders in the event of the possible bankruptcy of one of their number was agreed upon in good faith. Nevertheless, *in the event of a bankruptcy, such a provision must be considered to have been without consideration*, and merely a kind of conditional gift to one's fellow shareholders because of one's association with them in a closely held company… Thus, the trustee, who stands in the shoes of one of the shareholders, has the same rights as his predecessor in title, the bankrupt herein, would have had, with respect to the determination of the value of the shares…
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> 20 … There is no evidence before the court as to the existence of any consideration for such a reduction, other than a *desire to confer a benefit on one's fellow*

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34 See *BA*, s. 102.

35 See text accompanying *supra* note 9.

36 Clause 9.2.1 provided that the sale price of a voluntary transfer should be the "fair price of the shares being sold on a going concern basis between a willing seller and a willing buyer", as determined by an independent chartered accountant.

37 Jackson, *Bankruptcy Law*, *supra* note 23 at 40-44.

38 See Steven Schwarcz, "Rethinking Freedom of Contract: A Bankruptcy Paradigm" (1999) Tex. L. Rev. 515 at 594.

39 *Ibid.* at 595.

40 In comparison, balance sheet or cash flow insolvency at the time an undervalue transaction is entered into is a prerequisite for invoking s. 98 *BA*: see s. 100(4) *BA*.

> *shareholders in the event of one's bankruptcy, when presumably the interest that the selling shareholder has in the amount to be received is not as significant as where he is to receive the price for such shares himself, and not simply via a trustee for the benefit of the mass of his creditors*.[41]

The foregoing offers a justification for depriving the non-defaulting AIFMC shareholders of the value of their pre-insolvency rights conferred by clause 14.2.3 of the MSA, and not merely their right to have it transferred in accordance with clause 14. If correct, then *Peregrine* and *Re Frechette* represent a distinctive dimension of the anti-deprivation principle. The principle may also render contractual rights that operate solely upon insolvency wholly unenforceable as they are on balance, exploitative of unsecured creditors without offering commensurate compensating benefits. This is independent of the equally important concerns related to enforcing the mandatory collective basis of insolvency proceedings.[42] The latter rationale only calls for a limited interference with pre-existing contractual rights to the extent that they seek to confer an immunity on a particular creditor from them.[43]

However, the equally important policy concern that *bona fide* commercial transactions should not be easily upset, is also implicated.[44] Does this dimension of the anti-deprivation principle excessively undermine *bona fide* commercial transactions? It is suggested that the existence of a significant undervalue, coupled with a trigger predicated solely on factual insolvency or institution of insolvency proceedings, provides an appropriate bright line or signal to contractual counterparties to distinguish contractual provisions subject to the scrutiny of the anti-deprivation principle. These were at least apparent in the context of clause 14.2.2 and 14.2.3 of the MSA. Different considerations might apply where contractual provisions are not predicated to operate solely and severally on these contingencies and where the attendant agency costs are substantially mitigated. Although it remains to be seen how much further the decisions in *Peregrine* and *Re Frechette* will be taken in accordance with this particular rationale for the anti-deprivation principle, such a bright line distinction would appear to be an acceptable balance between the attendant costs imposed on third parties by any resulting uncertainty over the enforceability of contracts, and the need to mitigate agency costs imposed on unsecured creditors.[45]

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41 *Supra* note 13 at paras. 18-20, per Meyer J. [emphasis supplied].

42 Some support for this may also be found in the case of *Fraser v. Oystertec Plc.* [2004] BPIR 486 (Chancery Division, Patents Court), where the court held that a deprivation clause re-transferring a patent was null and void in the event of the acquiring company's factual insolvency even though no formal insolvency proceedings, mandating a collective enforcement process, had been commenced.

43 See Mokal, *supra* note 21 at 592-595; Jackson, *Bankruptcy Law*, *supra* note 23.

44 Prentice, *supra* note 33 at 77-78; Thomas Jackson & Douglas Baird, "Fraudulent Conveyance Law and its Proper Domain" (1985) 38 Vand. L. Rev. 829 at 838–839.

45 Admittedly, this reasoning goes against the grain of the majority's reasoning in *British Eagle*, *supra* note 2, and that of Blair J. in *Bramalea*, *supra* note 13, where emphasis was placed on the *effect* of the contractual provision rather than its particular form or trigger. This follows from the different underlying rationale adopted—the preservation of *pari passu* distribution in winding up—which has been criticised: see Mokal, *supra* note 21 at 598-601; Fidelis Oditah, "Assets and the Treatment of Claims in Insolvency" (1992) Law Q. Rev. 459 at 466. The courts will eventually have to revisit *British Eagle* as they grapple with the proper function(s) of the anti-deprivation principle and how the policies underlying collective winding up proceedings are to be balanced with freedom of contract and the need for commercial certainty.

B. Pari Passu *Distribution, Collectivity and the Applicable Pool of Assets*

This brings us to the second interesting issue raised in *Peregrine*. The foregoing discussion assumed that PII itself was placed in insolvent winding up, when in fact it was not. The liquidators of PIH nevertheless argued that the principle could still apply to prevent the transfer of PII's AIFMC shares by reason of PIH's winding up. The majority in *Peregrine* agreed:

> … if the subject matter is an asset of the company, *although not strictly property of the company* within the ambit of section 182, *if the effect of a contractual provision is to deprive the company of it or reduce its value to the detriment of the company's general creditors in insolvent liquidation*, that must equally be contrary to the public policy of equitable and fair distribution amongst unsecured creditors in insolvency.[46]

The anti-deprivation principle thus extended across the formal proprietary boundaries dividing the group's members to prevent the enforcement of clause 14, which operated to the ultimate detriment of PIH's creditors. By adopting this formulation, the court unavoidably engineered a stark, and perhaps unnecessary, clash between the separate legal entity doctrine in corporate law and the anti-deprivation principle. Insofar as the latter has substantive in addition to procedural concerns,[47] it must be remembered that insolvency law generally respects pre-insolvency rights.[48] Orthodox corporate law stipulates that a shareholder (or parent company) does not hold a legal or beneficial interest in the assets of the company (or subsidiary).[49] The separate juristic existence of the constituent companies of a group must be respected, especially where creditor interests are implicated.[50] It would follow that the anti-deprivation principle ought to have applied discretely to different companies within the group depending on which companies were actually insolvent and placed in winding up.[51] All assets held by the corporate group should not *ipso facto* fall within the protection of the principle unless, in view of *Adams v. Cape*, some justification existed for lifting the corporate veil that separated their distinct pools of assets.

Implicit in this argument is the fact that creditors are *prima facie* entitled to look only to their respective corporate debtor within the group for payment.[52] The value of their substantive and procedural rights against the various members of the group are not necessarily commensurable. Depending on the debt-equity ratios of various members, proof of debt values would vary according to the particular corporate debtor. Many unsecured creditors may in fact have bargained with members of the

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[46] *Supra* note 6 at para. 86, per Woo V.P. [emphasis added].

[47] As argued in Part III.A. above.

[48] *Re Smith, Knight & Co.* (1868) L.R. 5 Eq 223 at 226, per Lord Romilly; see also Oditah, *supra* note 45 at 468–474.

[49] A.J. Boyle ed., *Gore-Browne on Companies*, 44th ed. (London: Jordan, 1986), c. 1 at 1.008A, citing, *inter alia*, *Bank voor Handel en Scheepvaart NV v. Slatford* [1953] 1 Q.B. 248; Walter Woon, *Company Law*, 2nd ed. (Singapore : FT Law & Tax Asia Pacific, 1997), c. 13 at 443.

[50] *Ford & Carter Ltd. v. Midland Bank Ltd. and Anor* (1979) 10 Legal Decisions Affecting Bankers 182, 129 NLJ 543 (H.L.), per Lord Wilberforce.

[51] See *Manning v. AIG Europe (UK) Ltd.; Save Group plc (in liq.)* [2004] EWHC 1760, [2005] 1 B.C.L.C. 1 at para. 45, per Lloyd J.

[52] *Walker v. Wimborne* (1976) 137 C.L.R. 1 at 7, per Mason J.; *Re Southard & Co. Ltd.* [1979] 1 W.L.R. 1198, per Templeman J.

group on this basis, and to unravel corporate-contractual relations on the sole basis that members of the group are economically linked is to go directly against the grain of the established separate entity doctrine as applied to corporate group structures,[53] and legitimate creditor expectations.[54] However, if the *Peregrine* formulation is correct, the anti-deprivation principle would readily ignore the formalities of the corporate form, regardless of whether factual insolvency exists or insolvency proceedings are instituted in respect of all the relevant subsidiaries in the group. Instead, it would focus on the economic *reality* of the relationship between the insolvent parent and her subsidiaries.

Given the weight of current authority legitimating the use of the corporate groups to ensure legal liability in respect of particular activities be confined to designated corporate members,[55] it behooves a court administering a winding up to establish a valid reason for ignoring corporate forms beyond the assertion that they are essentially one economic entity. Woo V.P. thought that striking down clause 14 was not inconsistent with respecting these structures.[56] With respect, it is difficult to see how property that is was not legally or beneficially the property of PIH could nonetheless be subject to the strictures of the anti-deprivation principle, unless PIH's legal rights in respect of the AIFMC shares were somehow enlarged in winding up because it held an economic interest in the outcome of their treatment. If PII's assets were subject to the same collective or distributive discipline imposed by PIH's winding up, this must implicitly have been achieved by lifting the corporate veil between the two companies, even if only for one of those specified purposes.

Was there, nonetheless, some justification for piercing the corporate veil and consolidating the assets of PIH, PVC and PII? At first instance, Yuen J. carefully considered and dismissed the argument that PII was merely a bare trustee holding the AIFMC shares on behalf of PIH.[57] In was clear from the circumstances of PII's involvement in the AI Fund project that the Peregrine group intended PII to beneficially hold the AIFMC shares.[58] The facts also did not support the plaintiffs' argument that PII was a "nominee" or mere façade concealing the true nature of the Peregrine group's involvement in the AI Fund project and related fund management business. Although PII did not have an independent commercial business, it was incorporated to hold Peregrine's interest in the AI Fund and AIFMC. There was a consistent respect for the corporate form in the management of the affairs and accounts of PIH and PII.[59] Although PIH provided the funds for the acquisition of the AIFMC shares, these were reflected as intra-group debits and, correspondingly, the dividend stream from the investment holdings of PII were reflected as intra-group

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53 *Briggs v. James Hardie & Co. Pty. Ltd.* (1989) 16 N.S.W.L.R. 549 at 576, per Rogers A.J.A.

54 *In re Augie/Restivo Baking Co.* 860 F.2d 515 (2d Cir. 1988) at 518; see also Steven Schwarcz, "Collapsing Corporate Structures: Resolving the Tension between Form and Substance" (2004) 60 Bus. Law. 109 at 136-138.

55 See *supra* note 19.

56 *Supra* note 6 at paras. 90, 106.

57 *Supra* note 12 at paras. 73-77.

58 *Ibid.* at para. 75. Clause 2.1 of the MSA contained a representation and warranty by PII to the other AIFMC shareholders that it was the beneficial owner of the shares free from all liens charges encumbrances and third party rights.

59 *Ibid.* at paras. 91-109.

credits, presumably applied in progressive discharge of the original parent loans.[60] Furthermore, the distinct corporate structure and asset holdings were clearly reflected in Peregrine's annual accounts.[61] Consequently, even though PII was conceived as a subsidiary assigned the limited task of holding the AI Fund investment, the group was careful to ensure that PII held the investments independently from the other investment activities of the group. There was evidence that this was done principally for tax advantages should PIH desire to sell its stake in the AI Fund later.[62] The group structure would presumably also keep separate any risks associated with the AI Fund venture from the other investment activity of the group. A lifting of the corporate veil in these circumstances would not seem justified.

There are, of course, legitimate concerns about the abuse of group structures to the detriment of various categories of creditors *vis-à-vis* the group.[63] Corporate law confers great freedom on shareholders and companies to organize capital, and this freedom can be used to limit legal responsibilities without adequately compensating creditors who suffer as a result of the manipulation of capital boundaries.[64] It is noteworthy that certain jurisdictions have reined in the separate entity doctrine in the context of corporate group insolvency. For example, section 271(b) of the New Zealand *Companies Act 1993*[65] confers judicial discretion to order that the liquidations of two or more related companies must proceed together as if they were one company, and thus pool the assets *and* liabilities of a group. Similarly, under U.S. bankruptcy law, the doctrine of substantive consolidation allows a bankruptcy court to lift the veil of incorporation and consolidate the assets and liabilities of companies that have filed for bankruptcy.[66]

Nevertheless, in both these instances, pooling or consolidation orders can only be made under certain conditions, which offer an insight into the justifications for lifting corporate capital boundaries in order to protect creditors. In New Zealand, this is done where the court considers it "just and equitable".[67] Before it can order a pooling, the court *must* take into consideration, *inter alia*, the extent to which any of the companies took part in the management of any of the other companies, the conduct of any of the companies towards the creditors of any of the other companies, the extent to which the circumstances that gave rise to the liquidation of any of the companies are attributable to the actions of any of the other companies and the extent to which the businesses of the companies have been combined. In *Re Dalhoff and King Holdings Ltd.*,[68]

[60] *Ibid.* at para. 104. The subscription money for the shares, totalling US$314,925, was paid by PIH, and PII was debited this amount via PVC in the Peregrine group's accounts. Similarly, the subscription monies for PII's stake in the AI Fund were paid by PIH and debited to PII. All other expenses in the setting up of the AI Fund and AIFMC were also borne by PIH and similarly debited. Between 1996 and 1997, PII received $5 million in dividends from its AIFMC shareholding.

[61] *Ibid.* at para. 105-106.

[62] *Ibid.* at para. 109.

[63] See generally *supra* note 4; David Milman, "Groups of Companies: the Path towards Discrete Regulation" in David Milman ed., *Regulating Enterprise: Law and Business Organisations in the UK* (Oxford: Hart Publishing, 1999)

[64] Hugh Collins, "Ascription of Legal Responsibility to Groups in Complex Patterns of Economic Integration" (1990) 53 Mod. L. Rev. 731 at 736-737; Finch, *supra* note 4 at 406-410.

[65] (N.Z.), 1993/105.

[66] See *In re Continental Vending Machine Corp.* 512 F.2d 997 (2d Cir. 1975); *Eastgroup Properties v. Southern Motel Assoc.* 935 F.2d 245 (11th Cir. 1991) [*Eastgroup*].

[67] *Supra* note 65.

[68] [1991] 2 N.Z.L.R. 296

the court granted a pooling order on the basis that the directors treated the group companies as a single enterprise *and* that there was indeed a public perception to that effect. Likewise, under the doctrine of substantive consolidation, U.S. bankruptcy courts will only collapse the corporate structures in exceptional circumstances. As a minimum, there must be a substantial breakdown of corporate formalities between the companies considered for consolidation.[69] Further, the benefits of consolidating the assets and liabilities of different corporations must heavily outweigh harm to objecting creditors,[70] while some circuit courts are even stricter in requiring that there be no prejudice to the respective creditors of each member of the corporate group subject to consolidation.[71]

It may be surmised that even though courts in these jurisdictions have the power to collapse corporate forms in insolvency proceedings, they are extremely cautious in doing so. Pre-insolvency corporate-contractual arrangements are ignored either where there was no *general* expectation by the respective creditors of the group that the forms would be observed, or where the benefits of consolidation greatly exceed the harm to creditors of the group that result from consolidation. Although there was some reference by the majority in *Peregrine* to the fact that all the parties to the MSA regarded PIH as a *de facto* partner and co-owner in the AI Fund venture, this was clearly contrary to the findings made at first instance. Whatever perceptions the AIFMC shareholders may have held, it is the general perception of PIH and PII's creditors that is material. This issue was unfortunately not adequately addressed in *Peregrine*.

By emphasizing the importance of PIH's loss of economic value via the enforcement of clause 14.2.3, the court failed to address the issue of why PIH's shareholding rights were enlarged by the mere fact that it was placed in winding up. There is no apparent reason why, without more, formal corporate group structures should generally be disregarded in *lieu* of economic reality simply because one of the companies in the group goes into winding up, or even if the whole group does. But the *ratio* of the majority in *Peregrine* sweeps all the foregoing considerations aside with its broad formulation. As demonstrated, the implications are problematic as improper forum shopping incentives to place groups in formal liquidation proceedings are created when these may not be necessary.[72] Further, the court appears to have carved out a large loophole in the edifice of the separate entity doctrine and reintroduces the single economic entity argument utilized in *DHN Food Distributors Ltd. v. Tower Hamlets LBC*[73] by the back door, which has been disavowed by various Commonwealth authorities.[74]

Even if we shift gear and approach the problem from the perspective of the need for collective management of the insolvent estate,[75] it cannot be assumed that all the

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69 *Eastgroup*, *supra* note 66.

70 *Ibid.*; *In re Auto-train* 810 F.2d. 270 at 276 (D.C. Cir. 1987)

71 *In re Augie/Restivo Baking Co.*, *supra* note 54 at 516.

72 See Douglas Baird, "Loss Distribution, Forum Shopping, and Bankruptcy: A Reply to Warren" (1987) 54 U. Chicago L. Rev. 815 at 824-828.

73 [1976] 1 W.L.R. 852

74 *Adams v. Cape Industries plc.*, *supra* note 19; *Briggs v. James Hardie & Co. Pty Ltd.*, *supra* note 53, *Re Securitibank Ltd.* (No. 2) [1978] 2 N.Z.L.R. 136.

75 See Mokal, *supra* note 21 at 592-595; Michael Bridge, "Collectivity, Management of Estates and the *Pari Passu* Rule in Winding Up", in Armour & Bennett, *supra* note 33 at 1.

subsidiaries must necessarily follow the parent company's entry into formal liquidation. Theory and practice point the other way. Collective liquidation proceedings should only be invoked where there is a need to prevent a deleterious creditor scramble for assets.[76] It may consistently be in the interest of the creditors of an insolvent parent to see profitable subsidiaries continue to operate as a going concern and then be sold off. On the other hand, cost considerations may indicate that it would not be efficient to place all insolvent subsidiaries in winding up. Indeed, if considered necessary, the liquidators could procedurally consolidate administration of the winding up in relation to the whole group.[77] But until such a determination on behalf of the group is made, there should not be any presumption that the winding up of a parent necessitates a freeze on all transfers of value throughout the corporate group.

It is conceivable that the anti-deprivation principle as formulated in *Peregrine* could have a wide-ranging, unintended effect in striking down otherwise legitimate contractual transfers of value between wholly-owned subsidiaries and third parties. The crucial and logically prior question that needs to be asked is whether those transfers were legitimately enforceable vis-à-vis the relevant contractual counterparties in accordance with their pre and post-insolvency rights against the respective subsidiaries. Many commercial transactions like asset securitization depend on the recognition of pre-insolvency rights which include a maintenance of the separate treatment of corporate forms. Such a discerning approach to the management of corporate group insolvencies is adopted by U.S. bankruptcy courts. A consistent line of authority dealing with the scope of the automatic stay (the cornerstone of the collective bankruptcy process) holds that this stay cannot extend to assets of subsidiary companies.[78] American bankruptcy courts will simply not accept jurisdiction over such assets unless there is a valid substantive reason to disregard the established corporate boundaries.[79]

In summary, it is submitted that the approach *Peregrine* has chosen to deal with clause 14 of the MSA (relating to the problems caused in insolvency law by corporate groups) raises more problems than it resolves, and is difficult to reconcile with existing insolvency law principles. Cheung J.A. was right to be concerned about this being an area "where the whole spectrum of the ramifications of interfering with the subsidiary's contractual undertaking with a third party would be fully explored instead of being dealt with on a case by case basis."[80]

C. *The Anti-Deprivation Principle and Group Deprivation Clauses*

That said, the majority in *Peregrine* were nevertheless right to be concerned about the nature of clause 14 of the MSA. Essentially, it allowed the non-defaulting AIFMC shareholders to obtain PII's AIFMC shares at a significant undervalue, to the detriment of its own creditors and, ultimately, the creditors of insolvent PIH.

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[76] Jackson, *Bankruptcy Law*, *supra* note 23, c. 1.

[77] This is the practice in the U.S.—see for e.g. *In re Flora Mir Candy Corp.* 432 F.2d 1060 at 1062 (2nd Cir. 1970).

[78] See *In re Holywell Corp.* 118 B.R. 876 (USDC S.D. Florida); *In re Beck Industries Inc.* 479 F.2d 410 (2d. Cir 1973); *In re W.T. Mayfield Sons Trucking Co., Inc.* 225 B.R. 818 (USBC N.D. Georgia, 1998).

[79] *In re Regency Holdings (Cayman) Inc.* 216 B.R. 371 (USBC S.D. New York, 1998)

[80] *Supra* note 6 at para. 160.

This commentator suggests that it might still have been possible to utilize the anti-deprivation principle to check clause 14 without extending its reach beyond proper doctrinal or theoretical foundations. The proposed analysis turns on an important factual premise which was not clarified in the *Peregrine* judgments. Was PII itself factually insolvent? Unfortunately, the facts do not provide us with a definitive answer.[81] I therefore proceed to consider the implications in both financial scenarios.

1. *An insolvent PII*

If PII were factually insolvent, it would have been a simple expedient for the liquidators of PIH to place PII, a wholly-owned vertical subsidiary company, in winding up[82] the moment notice was received that the shares were about to be transferred. Thereafter, the straight-forward application of section 182[83] would render any disposition of PII's AIFMC shares void. However, section 182 merely renders the disposition void, and says nothing about the non-defaulting AIFMC shareholders contractual rights under clause 14. To get to the root of their objection to clause 14, the liquidators could then rely on the anti-deprivation principle as applied in *Re Frechette*[84] to render the clause unenforceable. The other AIFMC shareholders would thus not be able to file a proof of debt for contractual damages based on PII's failure to transfer its AIFMC shares. Even if the liquidators of PIH were not minded to place PII in winding up, or were unable to do so in time to prevent the impending transfer, it appears that they could still have used the anti-deprivation principle to achieve their objectives. In the recent case of *Fraser v. Oystertec Plc.*,[85] Prescott Q.C. sitting as a judge of the Commercial Court held that the principle was a "free standing" one capable of operating independently of the formal institution of any insolvency proceedings, and enforceable by the company itself and not just its liquidator.

2. *A solvent PII*

A more difficult challenge is posed if PII was solvent *even after* the AIFMC shares were transferred. By definition, there would be sufficient assets to pay all its own creditors, and the collective and distributive norms that underlie an insolvency proceeding *vis-à-vis* the creditors of PII would have no basis for operating. Essentially, the issue that arises is whether a deprivation or forfeiture clause triggered to operate upon the insolvency (factual or formal) of a wholly-owned subsidiary's parent

[81] PII relied on PIH as group treasurer for all its capital and expenditure. The AIFMC shares were subscribed utilizing an inter-group loan from PIH, and it appears that other 'debits' in favour of PIH were made. However, it appears that at substantial credits were also made in PII's favour by way of dividends paid to PIH. If these were used to offset all loans made by PIH, then it would appear that PII was a solvent subsidiary holding valuable assets. If there were any outstanding loans due to PIH, any other member of the Peregrine group of companies or an unrelated creditor, then certainly, the transfer of AIFMC shares as the only asset of PII would have rendered the company insolvent on any accounting analysis. However, the court in *Peregrine* did not make a definitive ruling on this as it was not fully explored at trial: *supra* note 6 at para. 3

[82] See s. 177(1)(d) of the *HKCO*.

[83] *HKCO*.

[84] See *supra* note 28 and accompanying text.

[85] *Supra* note 42.

should attract the same legal consequences as one contingent on the insolvency of the subsidiary itself.[86]

When a wholly-owned subsidiary is solvent and operates as a going concern, its directors generally look to the interests of the subsidiary as a whole.[87] However, this does not represent some abstract interest independent of the stakeholders in the company.[88] Generally, the interests are equated with those of its members as a whole, and under certain conditions, those of its creditors.[89] In the case of wholly-owned PII, this would be represented by the interests of PVC, as intermediate vertical parent, and PIH, as ultimate vertical parent in the Peregrine group. As PVC was also solvent on the facts, allowing us to eliminate consideration of the interests of PVC's creditors, the interests of PII's shareholder is represented ultimately by the interests of PIH as parent.

However, just as the directors of PII are not permitted to exclude consideration of its creditors when actually or contingently insolvent,[90] it is submitted that the directors of PII must similarly have considered the interests of PIH's creditors in situations where those creditors are the residual proprietary stakeholders in PIH. The main difference in the proceeding analysis from that in Part III A. above is the particular duty called into question. Here it is solely a function of PII's directors' duty to act in the interests of its members, and not its *own* creditors. However, even then, the duty cannot be formulated solely in relation to a homogenous interest group where the situation calls for a fair balancing between the conflicting interests of two sets of competing residual claimants.[91] Precisely because clause 14.2.3 was predicated to operate to the detriment of PII in the event of PIH's factual or procedural insolvency, the interests of PIH's creditors intruded. Rogers V.P. in *Peregrine* expressed the very same concern in justifying the majority's expansion of the anti-deprivation principle—that there should also be a positive duty to protect the interests of the group parent's creditors:

> …What, therefore, the shareholders of AIFMC have done by clause 14 of the [MSA] was to provide for an alienation at an under value upon the happening of a bankruptcy… Whilst giving full recognition to the fact that a subsidiary is a self-governing independent company, nevertheless, particularly in this present case, it is still an asset of the parent. PII might have been autonomous in one sense but it was not anarchistic. *Even as a self-governing asset, is was its responsibility, and that of its directors, to maintain its value*.[92]

The costs of clause 14.2.3, insofar as it triggered the undervalue transfer of PII's AIFMC shares upon the insolvency of PIH, would be imposed solely on the creditors of PIH. In contrast, the benefits of clause 14.2.3 would only accrue in situations where

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86 As discussed in Part III.A above.

87 *Re Smith & Fawcett Ltd.* [1942] Ch. 304 at 308-9; *Brady v. Brady* [1988] B.C.L.C. 20 at 40; *Walker v. Wimborne, supra* note. 52.

88 *Greenhalgh v. Arderne Cinemas Ltd.* [1951] Ch. 286 at 291

89 See H.A.J. Ford, R.P. Austin & I.M. Ramsay, *Ford's Principles of Corporations Law* (Sydney: Butterworths, 1995), Vol. 1 at 8089-8090.

90 Steven Schwarcz, "Rethinking a Corporation's Obligations to Creditors" (1996) 17 Cardozo L. Rev. 647 at 665-668 [Schwarcz, "Obligations to Creditors"].

91 See *Mills v. Mills* (1938) 60 C.L.R. 150 at 164, per Latham C.J.

92 *Supra* note 6 at paras. 31, 34 [emphasis added].

PIH and PII remained solvent, and would unlikely flow through to its creditors given their fixed credit interests in the parent company. Consequently, notwithstanding the distinct legal personalities within the group structure, essentially the same moral hazard is replicated by that corporate structure in negotiating clause 14 of the MSA in relation to the interests of PIH's creditors. If unmitigated, PII's directors would have the incentive to take unacceptable risks not only vis-à-vis its own creditors, but also those of its vertical parent. It is submitted that this concern cannot be adequately addressed by relying on the duty of directors to simply *bona fide* consider PIH's creditors' interests and act fairly insofar as this categorically conflicted with those of its shareholders.[93] PII was disproportionately imposing the costs of clause 14 solely on the creditors of PIH, under purely anticipatory conditions where (a) there were genuine concerns about their objective ability to assess the true cost to PII and the Peregrine group when dealing with a non-public, contingent arrangement represented by clause 14.2.3 and (b) the affected stakeholders had no expectation of notice of the prejudicial arrangement nor a legal right to intervene.[94]

In this scenario, it is submitted that the enforceability of clause 14 would still fall within the scrutiny of the anti-deprivation principle as an aspect of its function in ameliorating the agency cost problems associated with *ipso facto* clauses of the kind used here. Contractual provisions like clause 14.2.3 that purport to allow the *de facto* forfeiture of a wholly-owned subsidiary's property upon the insolvency of a parent should likewise be rendered wholly unenforceable to ameliorate the perverse incentives that arise by reason of limited liability in corporate group context. Thus, while this commentator may disagree with the actual adaptation of the anti-deprivation principle adopted by the majority in *Peregrine*, their motivating concern was well justified. The anti-deprivation principle can and should also function to regulate creditor misbehaviour that affects not only the company's immediate creditors, but also those further upstream in a corporate group. This can be done without ignoring the formal corporate structure of the group, and coherently with the fiduciary duties of the subsidiary's directors to that company. If this more limited interpretation of the principle is accepted, it offers a unique remedy protecting the hierarchy of creditor interests in the vertical corporate group while avoiding a wholesale junking of pre-insolvency corporate-contractual rights. It also operates as an analogue to statutory avoidance provisions like undervalue transactions, cautiously extending its reach in both chronological[95] and fiscal[96] terms with an eye on reconciling this with the importance of generally respecting rights bargained for pre-insolvency.

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[93] Schwarcz, "Obligations to Creditors", *supra* note 90 at 675-676, argues that when balancing these conflicting interests, "directors should have latitude to make their own good faith weighing of benefit and harm, recognizing that harm to creditors may well be more significant benefit to shareholders." He further suggests that where there are non-comparable commodities of benefit and harm to different interest groups, "the benefits may have to considerably outweigh the harm, or at least provide a compelling case, to be justified". The weight of current authority is, however, likely to point to a subjective *bona fide* assessment: see *Mills v. Mills*, *supra* note 91; *Re Welfab Engineers Ltd.* [1990] B.C.L.C. 833; *Facia Footwear Ltd. v. Hinchliffe* [1998] 1 B.C.L.C. 218. Nevertheless, the more harmful the transaction to creditor interests, the more difficult it will be for a director to prove that he honestly believed it to be in the company's interests: *Regentcrest plc. v. Cohen* [2001] 2 B.C.L.C. 80 at 105.

[94] See *supra* notes 37 to 39 and accompanying text.

[95] At least only to deprivations of value that occur *after* the commencement of winding up.

[96] If the anti-deprivation principle applies whenever upstream creditor interests in a group are implicated, even though the company in question is not insolvent at the time of the deprivation, or as a result of it.

IV. Conclusion

The *Peregrine* litigation offered a unique opportunity to put the underlying rationales of the anti-deprivation principle under further scrutiny. The result in *Peregrine* and the authorities cited in support suggest that it might be premature to dismiss entirely any non-collective rationale offered in support of the principle in favour of one exclusively premised on the mandatory collective nature of insolvency proceedings. The anti-deprivation principle also renders pre-insolvency contractual provisions, and in particular *ipso facto* deprivation clauses, wholly unenforceable in instances of an abuse of corporate debtor powers where the costs of such transactions are borne solely or disproportionately by the creditors of an insolvent company or group. This is so even when no exemption from collectivity is implicated. In these instances, the principle reflects the concerns of a different stream of rules concerned with regulating corporate debtor misbehaviour that affects the interests of a company's creditors.

Further, caution needs to be maintained to avoid an unduly wide interpretation of the principle focused solely on the economic effects of a contractual deprivation in a corporate group, without due regard to pre-insolvency corporate-contractual relationships. The broad spin given to the principle by the majority in *Peregrine* is likely to create more problems than it resolves as it subverts pre-existing rights without adequate justification for a *de facto* consolidation of assets in a corporate group insolvency situation. With this in mind, it has been argued that the principle is nevertheless flexible enough to protect the interests of a hierarchy of creditors dealing with a corporate group from the improper *ipso facto* deprivation of property from the group, based on the need to ameliorate perverse management incentives created by limited liability in that context. Finally, at a more general level, *Peregrine* also highlights the continuing need to formulate clearer legislative policies and principles with respect to the treatment of corporate group structures, assets and liabilities in insolvency proceedings.