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News Bulletin

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Lehman Brothers Appeal Judgment Confirms Enforceability of Flip Clauses

The judgment in the case of *Belmont Park Investments Pty Limited v BNY Corporate Trustee Services Limited and Lehman Brothers Special Financing Inc (UKSC 2009/0222)*, which began to be heard by the UK Supreme Court on March 1, 2011,[1] was handed down on July 27, 2011. The case concerns the enforceability of so-called "flip clauses," which provide that payment obligations owed to different creditors, in this case the swap counterparty and the noteholders, "flip" in priority following a counterparty bankruptcy. Both the High Court of England and Wales and the Court of Appeal of England and Wales found that flip clauses were enforceable under English law. In a judgment issued on July 27, 2011, the UK Supreme Court upheld the decision of the Court of Appeal of England and Wales by a unanimous decision of all seven judges.

The *Belmont Park* ruling of the UK Supreme Court resolves some of the uncertainty surrounding flip clauses by confirming the enforceability of flip clauses under English law. Prior to this judgment being handed down, there was uncertainty as to whether the English law provisions commonly used in European and Asian structured products would be upheld. Within the context of the divergence of the respective decisions of the courts of England and Wales and the U.S. court in the *Perpetual Trustee* litigation,[2] *Belmont Park* was seen as the "test case" to confirm the English law position relating to the enforceability of flip clauses in the highest court in the UK. However, while the UK position is not subject to further appeal, the issue may come before U.S. courts again in other actions.

Belmont Park is of major significance to the global structured finance market and to the lending market more broadly. Although *Belmont Park* has resolved considerable market uncertainty in relation to the enforceability of flip clauses under English law, the divergence from the U.S. *Perpetual Trustee* case means that it is a "game changer." In future transactions, there will be more focus on the jurisdiction under which a counterparty falls. In some circumstances, parties may prefer when possible to avoid contracts with counterparties that are subject to U.S. bankruptcy laws, under which flip clauses are not enforceable. Issuers may even consider re-structuring existing securities.

In any event, financial institutions would be wise to discuss with their lawyers the implications of *Belmont Park* and the U.S. *Perpetual Trustee* case for the documentation, execution and structuring of transactions. For a discussion of structuring options for new and existing structured finance deals due to the disparity between U.S.

[1] See Morrison & Foerster client alert: Lehman Brothers Flip Clause Appeal Set to Be Heard Before UK Supreme Court (March 1, 2011), http://www.mofo.com/files/Uploads/Images/110301-Lehman-Brothers-Flip-Clause-Appeal.pdf.

[2] The *Perpetual Trustee* litigation consists, in the U.S., of the decision of the U.S. Bankruptcy Court for the Southern District of New York in *Lehman Brothers Special Financing Inc. v. BNY Corporate Trustee Services Ltd.*, Case No. 08-13555 (Bankr. S.D.N.Y. January 25, 2010), and in England and Wales, of the High Court decision in *Perpetual Trustee Co Ltd v BNY Corporate Trustee Services Ltd & Anor* [2009] EWHC 1912 (Ch), which was later confirmed by the Court of Appeal in *Perpetual Trustee Company Limited and others v BNY Corporate Trustee Services Limited and others and Butters and others v BBC Worldwide Limited and others* [2009] EWCA Civ 1160.

and English law, please see the section entitled "Implications for legacy and future transactions" in our article "Flip Flop on Flip Clauses Continues" in the February 28, 2011 edition of *Total Securitization*, available here.

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