



Bankruptcy & The Matrimonial Home

SGH Keynotes, February 2004

**Sprecher Grier Halberstam LLP
30 Farringdon Street
London EC4A 4HJ
DX 53333 Clerkenwell
Tel: 020 7544 5555
Fax: 020 7544 5565**

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1. Biography



DANIEL SEJAS was admitted in 1996, and joined the firm's Insolvency Department in 1997, having acquired substantial experience of insolvency law and commercial litigation with a well-known London firm. He became the firm's youngest ever partner in 1999, at the age of 28.

He specialises in insolvency, concentrating primarily on contentious insolvency. Daniel acts almost exclusively for insolvency practitioners, although he also advises debtors, creditors secured lenders etc. Daniel has considerable experience of both corporate and individual insolvency, covering the whole scope of insolvency matters including: petitioning for administration orders, 'out of Court' administrations under the Enterprise Act 2002, assisting administrators in the conduct of their administration, advising administrative receivers as to the validity of appointment, acting for liquidators in pursuing former directors, advising insolvency practitioners and debtors/companies in relation to voluntary arrangements, and extensive experience on advising insolvency practitioners on all aspects of personal insolvency, acting for creditors and advising company directors faced with disqualification proceedings.

Daniel's clients appreciate the quality of legal advice that he renders, his prompt proactive service, his strong commercial sense, and consider him a highly assertive litigator. His global knowledge of insolvency allows him to give clients the most proactive and realistic advice.

He lectures widely on insolvency law, and is a regular speaker at R3 conferences.

Daniel speaks fluent Spanish and French, and has a Masters in French Law (University of Bordeaux – France).



IAN GRIER is a leading insolvency specialist. He was admitted in 1972 and initially practised commercial litigation in a medium sized London firm. From 1977, he focused on insolvency law and rapidly became a well-known expert. He co-founded the firm with David Sprecher in 1984.

He is a licensed insolvency practitioner and Fellow of the Association of Business Recovery Professionals (R3)

His well established reputation stems not only from the popularity of several textbooks he has co-written on insolvency law, but also and essentially from many years of handling the complete range of insolvency matters.

Ian heads the Insolvency Department and deals with all aspects of corporate and individual insolvency. Whether providing the broadest assistance to insolvency practitioners (with liquidations, receiverships, bankruptcies and voluntary arrangements), devoting his expertise to the rescue, restructuring and/or disposal of businesses in difficulty, or advising directors facing legal responsibilities, his approach remains equally solution oriented. His expertise also covers Court appointed receiverships and LPA receiverships.

2. Introduction

The last two years have seen a significant period of change insofar as concerns insolvency law within the jurisdiction, and indeed throughout the European Union through mutual recognition of insolvency proceedings within Member States (with the exception of Denmark).

Whilst no wholly new insolvency procedures have been created per se, within the jurisdiction, the Government has taken the opportunity of passing Acts of Parliament that makes substantial amendments to current insolvency procedures.

The personal insolvency provisions of the Enterprise Act 2002, the vast majority of which are due to come into force on **1 April 2004**¹, are the latest provisions affecting insolvency law that have recently been introduced by the Government.

Indeed, during the course of the last two years, the following significant legislation has (or is about) to come into effect:

<u>Date enforced</u>	<u>Legislation/regulation</u>	<u>Reference</u>
31/05/02	European Union Insolvency Regulation	Council Regulation (EC) No. 1346 of 2000
01/01/03	Balance of Insolvency Act 2000, including Schedule 3 (introducing, primarily, non-interim order IVA procedure)	SI 2002 No. 2711
15/09/03	Corporate insolvency provisions of Enterprise Act 2002, together with abolition of Crown preference and amendment of Schedule 5 Insolvency Act 1986	SI 2003 No. 2093
01/04/04	Balance of personal insolvency provisions contained in the Enterprise Act 2002	SI 2003 No. 2093

The introduction of the personal insolvency provisions, contained both in the Insolvency Act 2000 and the Enterprise Act 2002, represents the Government's attempt to update the current bankruptcy regime so as to try to bring the same in line with the current economic climate. There has also been a notable attempt to reduce the stigma associated with insolvency procedures, and in particular bankruptcy. The Government's intention, in implementing the relevant legislation, is to place the emphasis on '*rescue culture*'.

The intervening period, since the introduction of the Insolvency Act 1986, has seen rapidly increasing property prices, low interest rates, and ever increasing levels of consumer debt. Indeed the level of bankruptcies are currently running at their highest level since the 1960s, and in view of the ever increasing level of consumer debt it is currently estimated that the average person's (within the jurisdiction) liabilities exceed their assets by 134%². In view of

¹ Save for the provisions concerning the abolition of Crown preference, and the amendments to Part 1 Schedule 5 Insolvency Act 1986 (Trustee's powers), which came into effect on 15 September 2003

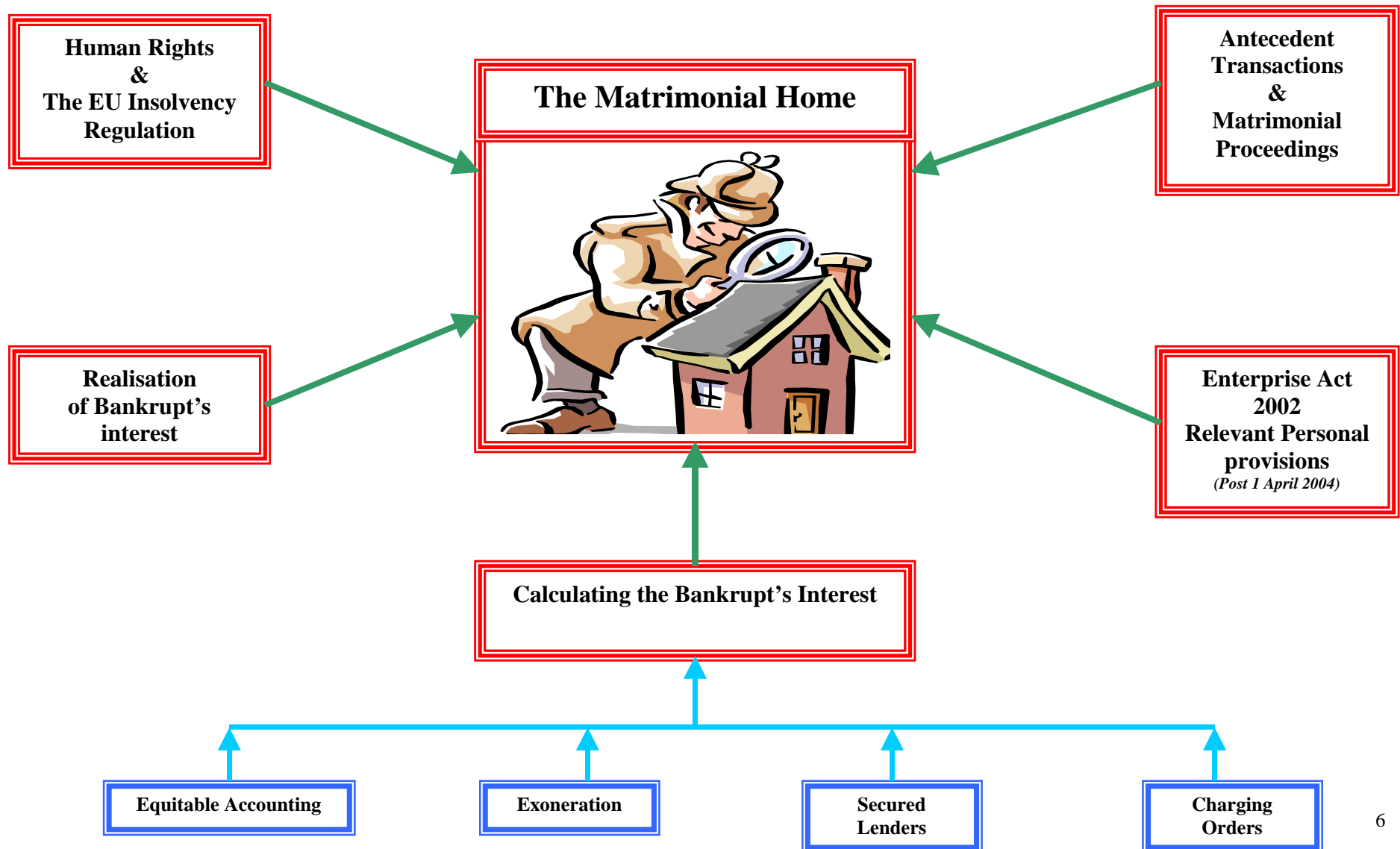
² Capital Investment Partners Intelligence, January 2004

this, and in view of likely increases in the base rate, combined with a potential stagnation/deterioration in the housing market, the perceived view is that it is likely that we will see an ever increasing number of bankruptcies in the foreseeable future – especially bearing in mind the new shorter discharge provisions to be introduced by the Enterprise Act 2002 (as from 1 April 2004).

The purpose of these notes is to concentrate on relevant factors and legislation insofar as concerns the matrimonial home. In most bankruptcies, the bankrupt's interest in the matrimonial home is usually the largest asset in value. Indeed it is not unusual for the matrimonial home to be the only asset capable of realisation.

The purpose of these notes is to provide a précis of the matters that a Trustee in Bankruptcy ought to bear in mind vis-à-vis the matrimonial home.

3. Summary of Key Features



4. Calculation of the Bankrupt's interest in the matrimonial home

As aforesaid, the bankrupt's interest in the matrimonial home is usually the largest asset in a bankrupt's estate. This has arisen largely as a result of:

1. the rapid increase in the number of privately owned homes following the Second World War, and indeed the sale of Council houses as from the 1980s during the tenure of Margaret Thatcher as Prime Minister; and
2. the intervening dramatic increase in property prices, driven largely by the escalating levels of private wealth.

Before taking a decision whether or not to apply for an order for sale, or to consider selling the bankrupt's interest in a property to the non-bankrupt spouse, it is important for the Trustee to calculate the quantum of the bankrupt's proprietary entitlement.

In general the entries at HM Land Registry are conclusive, in the absence of evidence to the contrary.³

Where a property is registered at HM Land Registry in the joint names of the bankrupt and his/her spouse as *joint tenants*, in the absence of evidence to the contrary, each spouse is entitled to 50% of the net equity.

In addition to holding properties at joint tenants, the entries at HM Land Registry may reveal that a property is held as *tenants in common*. Ownership as tenants in common is indicative that an agreement was reached as at the date of purchase that the registered owners hold their interests in a property in specified proportions. The Trustee will need to consider the contents of any contemporaneous declaration of trust, with a view to ascertaining the intention of the parties as at the date of purchase. The difficulty in this regard is that often such agreements are not reduced to writing, and the Trustee in Bankruptcy is unable to give any direct evidence as to the relevant events as at the time of registration of the property as tenants in common.

It ought also to be borne in mind that the making of a bankruptcy order serves so as to sever the joint tenancy upon the making of a bankruptcy order.

4.1 Equitable accounting

As stated above, in the absence of evidence to the contrary, the entries at HM Land Registry are deemed to be conclusive evidence as to proprietary ownership. However Trustees ought not to lose sight of the fact that, in addition to third parties attempting to establish they are entitled to a share in the matrimonial home, a Trustee in Bankruptcy can use relevant evidence to attempt to suggest that a bankrupt is in fact entitled to greater than 50% of the net equity.

The fact that a property is registered in the sole name of a bankrupt, or the bankrupt's spouse, does not necessarily mean that the co-habitee is not entitled to a proprietary interest.

³ *Re Gorman* 1990 1 All ER 717

The co-habitee who is not the registered owner of a property may be able to avail themselves of the principles of equitable accounting⁴. In its simplest terms the principles of equitable accounting can be summarised as an exercise whereby the Court considers what contributions have been made by the co-habitees towards a property, and uses such direct/indirect contributions to ascertain whether the non-registered owner is entitled to a constructive/resulting/implied trust over the whole or part of the property. The basic principles were summarised by Lord Diplock in *Gissing v Gissing*⁵:

“A resulting, implied or constructive trust – and it is unnecessary for the present purposes to distinguish between these classes of trust – is created by a transaction between the Trustee and the Cestui que Trust in connection with the acquisition by the Trustee of a legal interest in land, whenever the Trustee has so conducted himself it will be inequitable to allow him to deny to the Cestui que Trust a beneficial interest in the land acquired and he will be held so to have conducted himself if by his words or conduct he has induced the Cestui que Trust to act to his own detriment in the reasonable belief that by so acting he was acquiring a beneficial interest in the land”.

In addition to reported case law concerning bankruptcy, it is also important to consider matrimonial cases.

When calculating the bankrupt’s entitlement, the Trustee should consider the following:

1. Was any agreement reached between the parties prior to, or as at, the date of purchase of a property (e.g.: declaration of trust – which may be evidenced by a property being held as tenants in common).
2. What contributions did the parties make towards the purchase price (e.g. deposit). Direct contributions towards the purchase price are indicative of an interest in land, notwithstanding in whose name a property is registered.
3. If the non-bankrupt spouse did not make any direct contributions towards the purchase price, have any payments been made towards the mortgage or upkeep of the property. It should be noted that:
 - a. Contributions towards an interest only mortgage will not necessarily increase the level of the net equity in the property, and consequently are unlikely to give rise to a proprietary interest per se. It is therefore also important for a Trustee to consider the type of mortgage in place;
 - b. Contributions made to a mortgage post bankruptcy will not ordinarily give rise to an additional proprietary interest, since such payments are offset against the occupational rent that a trustee could otherwise charge for allowing a bankrupt and his wife to remain in occupation⁶.
4. Were any contributions being made by the non-registered proprietor towards improvements (e.g. extensions) to the property? Such contributions may give rise to a trust in favour of the non-bankrupt co-habitee.
5. If the non-bankrupt spouse did not make any contributions towards the purchase price, the mortgage or improvement of the property, have any payments been made towards housekeeping/redecoration (by way of contribution) so as to enable the mortgage to be paid by the registered proprietor. If so, the Court may attempt to use

⁴ *Re Pavlou*

⁵ 1971 AC 866 at p905

⁶ *Re Gorman; Re Byford 2003*

such indirect contributions so as to treat the same as if they had been a proportion of the whole of the purchase price⁷.

6. Does the principle of equity of exoneration apply in favour of either spouse (see separate section below).
7. Insofar as concerns secured lenders, the validity of the charge may also need to be considered (see separate section below).
8. The entries at HM Land Registry may also reveal cautions/restrictions/inhibitions protecting (for example) charging orders. Again the validity of such registrations will also need to be considered (see separate section below).

4.2 Principle of equity of exoneration

The principle of equity of exoneration set out in Hallsbury Laws of England⁸, as approved by Mr Justice Scott J in *Re Pittoriou*⁹, is as follows:

“If the property of a married woman is mortgaged or charged in order to raise money for the payment of her husband’s debts, or otherwise for his benefit, it is presumed, in the absence of evidence ... to the contrary, that she meant to charge her property merely by way of security ... in such case she is in a position of surety and is entitled to be indemnified by her husband and to throw the debts on his estate to the exoneration of her own ...”.

In other words where a property belonging to two people is mortgaged, and the proceeds of the mortgage used for injection in a business vehicle (for example, sole trader, limited liability company) owned by only one of the registered owners, if the presumption is established, the amount owing to the secured lender will be discharged in its entirety from the share in the equity owned by the party who has benefited from the mortgage proceeds - thereby exonerating the other owner’s share).

Although Mr Justice Scott J phrased the principle of equity of exoneration as operating in favour of a wife, there is no cogent legal reason why it could not operate in favour of a non-bankrupt husband.

Indeed there is also no reason why a Trustee cannot use the principle to his advantage, with a view to trying to enhance the bankrupt’s share in a property.

Although described as a ‘*presumption*’, the presumption is not such so as to automatically cast the burden of rebuttal upon the bankrupt’s spouse¹⁰. Rather the Court will consider all of the evidence relating to the raising of money secured against a property, the granting of a charge, the distribution of the money raised, and the intentions of the parties at the time. Thereafter the Court will decide whether the presumption applies. If it does, the burden of rebuttal thereafter falls on the other party (against whom the presumption applies).

If the principle of equity of exoneration applies, it could significantly reduce (or perhaps increase) a bankrupt’s interest in the net equity. The non-bankrupt spouse stands as surety, and can claim an indemnity from the bankrupt’s share of the net equity in the property for the monies due to the charge-holder (from whom the bankrupt raised the monies in question). The principle only applies if the monies secured by way of a charge are raised to pay the bankrupt’s debts or otherwise for his benefit.

⁷ *Lloyds Bank Plc v Rosset & Another* 1991 HL 1 AC 107

⁸ *Volume 22 paragraph 1071*

⁹ *A Bankrupt* 1985 1 All ER 285

¹⁰ *Paget v Paget* 1898 1 Ch 470

Example

For the purposes of this example it is assumed that we are dealing with a property registered in the joint names of Mr A and Mrs B as joint tenants. Mr A was adjudged a bankrupt in December 2003. It is further assumed that there are no costs of sale (Estate Agent's costs, legal fees etc). The open market value is £100,000, and which is subject to the following charges:

<u>Mortgagee</u>	<u>Amount owed (£)</u>
Friendly Bank – registered upon purchase	50,000.00
Sub-prime lender – registered January 2003	25,000.00

Ordinarily the bankrupt's interest in the property can be calculated as follows:

<u>Description</u>	<u>£</u>	<u>£</u>
Open market value of property		100,000.00
<u>LESS</u>		
Amounts due to mortgagees:		
Friendly Bank	50,000.00	
Sub-prime lender	<u>25,000.00</u>	<u>75,000.00</u>
Net equity		£25,000.00
		=====
Mr A's (bankrupt's) share in property		£12,500.00
Mrs B's share in property		£12,500.00
		=====

Following the Trustee's investigations it appears that the second charge in favour of Sub-Prime lender was a re-mortgage, and that following the re-mortgage Mr A (the bankrupt) obtained the entirety of the net re-mortgage monies of £25,000 – and used these to purchase shares in a public limited company that were held throughout solely in his name.

Since the re-mortgage proceeds were used to acquire an asset in relation to which the bankrupt received the sole benefit, in this instance it is highly arguable that the non-bankrupt spouse will be entitled to avail herself of the principle of equity of exoneration, and consequently the liability in respect of the re-mortgage will be thrown in its entirety to be borne by the bankrupt's share in the net equity.

Assuming this is the case, as a result of the applicability of the principle of equity of exoneration, Mr A's (the bankrupt's) share in the net equity can be recalculated as follows:

<u>Description</u>	<u>£</u>	<u>£</u>
Open market value of property		100,000.00
LESS		
Amount outstanding to Friendly Bank, first charge-holder	<u>50,000.00</u>	<u>50,000.00</u>
Net equity to which both Mr A and Mrs B are entitled		50,000.00
		=====
Mrs B's share in net equity @ 50%		25,000.00
Mr A (the bankrupt's) share in the net equity @ 50%		25,000.00
		=====
LESS Applicability of principle of equity of exoneration:		
C/f bankrupt's entitlement in net equity		25,000.00
LESS		
Amount owing to Sub-Prime, obtained solely for the benefit of the bankrupt		(25,000.00)
		=====
Mr A's (Bankrupt's) share in net equity, less principle of equity of exoneration		£NIL
		=====

Re Pittoriou is still the leading case in this field of law. Careful consideration should be given to the ends to which money raised by way of mortgage have been applied. The principle of equity of exoneration will not apply:

- Where money has been raised, and secured against the matrimonial home, to discharge the non-bankrupt spouse's debts/obligations, or otherwise for his/her benefit, or to maintain an extravagant lifestyle¹¹ (for example payments towards the mortgage, or the running of the family household).
- Where the mortgage, which may be subject to the principle of equity of exoneration, is taken out immediately or shortly before a mortgage being redeemed in full. In such a situation the Court will consider both transactions (i.e. the obtaining and settlement of the two mortgages) to be a single transaction, which excludes the non-bankrupt spouse's claim to an indemnity. This is the case even where the money raised is more than is necessary for the purpose of redemption¹².

¹¹ *Gray v Dowman* 1858 27 AJ Ch 702

¹² *Lewis v Nangle* 1752 Cox Eq Cas 240

- If at any time the non-bankrupt spouse disclaims his/her right to the equity of exoneration. For example where a deceased's executive pays legacies on the basis of such disclaimer¹³.
- By way of rebuttal, where evidence is produced showing that the spouse intended to make a gift of the property (to the extent charged) to the bankrupt¹⁴.
- Where money raised is used to pay debts that, although legally those of the bankrupt's spouse, have been incurred by reason of an extravagant lifestyle from which both parties have benefited.¹⁵

4.3 Secured lenders – Validity of charge

In general terms, the rights of secured lenders are unaffected by insolvency procedures.

The Trustee ought however to be wary where there is an allegation that secured monies were raised, to be used by one spouse for the purpose of (say) a solely owned business, and where the non-bankrupt spouse has been improperly advised or not advised at all. There could potentially be an allegation that the mortgage has been obtained by the bankrupt improperly, and the non-bankrupt spouse (and conversely the bankrupt through his Trustee) may be able to argue that a charge has been obtained by way of duress/misrepresentation/undue influence.

Where such allegations succeed, a secured lender will not be entitled to recoup its security (by way of order for sale or otherwise) as against the successful party's share of the property. Rather, since a mortgage debt will be joint and several, the secured lender will invariably attempt to recover the monies owing in its entirety from the other proprietor's share of the property. This could serve so as to reduce the bankrupt's interest in a property to £nil, or conversely to increase the same.

In view of the principles established in the House of Lords in *Royal Bank of Scotland Plc v Etridge (No. 2)*¹⁶, in *Barclays Bank Plc v O'Brien*¹⁷, and in *Mortgage Corporation v Shaire*¹⁸, this ought not to be a significant issue in the future. Banks now invariably ensure that the co-proprietor of the property, usually the wife, obtains independent legal advice as to the nature and consequences of the proposed mortgage and the seriousness of the risks involved. The solicitor rendering such advice is not necessarily obliged to be satisfied that the wife was free of undue influence when consenting to a charge being entered against a property.

4.4 Validity of charging orders

Care ought also to be taken when considering entries at HM Land Registry, particularly in respect of any party holding a restriction/caution/inhibition. Such entries may be seeking to protect a charging order against the property.

Charging orders are invariably based upon judgment debts, and only attach to the proprietary interest in a property owned by the judgment debtor. The entries at HM Land Registry will not

¹³ *Clinton v Hooper* 1791 3 Bro CC 201

¹⁴ *Hall v Hall* 1911 1 Ch 487

¹⁵ *Paget v Paget*, reference as above

¹⁶ 2001 UKHL 44

¹⁷ 1994 1 Ac 180

¹⁸ 2000 80 P&CR 280

reveal against which of the registered proprietors a charging order has been made, and will not reveal the amount outstanding. The Trustee will have to make enquiries of the holder of the adverse entry.

It has previously been held that office-holders are only bound by final charging orders (formerly charging orders absolute), and not by interim charging orders (formerly charging orders nisi)¹⁹.

However in view of the principles established by the Court of Appeal in *Mountney v Treharne* 2002, arguably this may no longer be the case. In *Mountney* the Court held that the making of a property adjustment order by the Court created an equitable interest subject to which a Trustee was bound. It could, by analogy, be potentially argued that an interim charging order (charging order nisi) creates a similar equitable interest. Nevertheless, this remains to be determined as a matter of law.

The holder of a final charging order (charging order absolute), and perhaps the holder of an interim charging order (charging order nisi) (see paragraph above), rank as secured creditors. The holder is entitled to ongoing statutory interest, and costs of enforcement, under the terms of its security post-bankruptcy²⁰.

4.5 Summary – Calculating the bankrupt’s interest

Although therefore at first glance the entries at HM Land Registry are conclusive, in reality they represent little more than a starting point for the Trustee’s investigations.

The entries on the Land Register deal with ‘*legal*’ ownership. Legal ownership does not necessarily reflect the ‘*equitable*’ ownership of a parcel of land. When considering the parties’ respective interests in a property, the Court considers all relevant factors, and conducts an equitable accounting exercise.²¹ so as to determine each party’s share.

¹⁹ *Roberts Petroleum Limited v Bernard Kenny Limited (In Liquidation)* 1983 2 AC 192

²⁰ *Ezekiel v Orapko* CA 1996

²¹ *Per Re Pavlou* 1993 1 WLR 1046

5. Antecedent transactions & inter-action with matrimonial proceedings

This should be considered where there are ongoing, or recent, matrimonial proceedings, and moreover where there have been any recent changes in the Proprietorship Register of a particular parcel of land.

Any transfer of a property ought to be investigated, should it fall within a relevant time for the purposes of s341 Insolvency Act 1986, and consideration given as to whether the same can be set aside as a transaction at an undervalue and/or voidable preference²². Any transfer ought to be carefully scrutinised to ascertain precisely what consideration the bankrupt's estate received. It is not unknown for property to be transferred to non-bankrupt spouses in view of the impending bankruptcy/insolvency.

If a transfer falls outside of a relevant time, for the purposes of s341 Insolvency Act 1986, consideration ought to be given as to whether any transfer can be attacked as a *transaction defrauding creditors*²³. This section of the insolvency legislation ought only to be considered where a transfer falls outside of a *relevant time*, since in addition to transaction at an undervalue '*intent*' also needs to be established. Furthermore, in relation to a claim pursuant to s423 Insolvency Act 1986, the Trustee is unable to avail himself of statutory presumptions afforded by ss339-341 Insolvency Act 1986.

Great care ought to be taken when a property adjustment order has been entered into, transferring the property from the bankrupt to the non-bankrupt spouse, in matrimonial proceedings.

It had previously been the case that, notwithstanding any property adjustment order made, a Trustee was not bound by the same unless the transfer had been registered at HM Land Registry prior to commencement of bankruptcy²⁴.

However it was held by the Court of Appeal in 2002 that a property adjustment order created an equitable interest in favour of the spouse to whom the property was to be transferred as a result of a property adjustment order²⁵. Although in *Mountney* subject to the transfer of the property not having been effected at HM Land Registry, the assets still fell within the estate in bankruptcy, the Trustee took the same subject to the non-bankrupt spouse's equitable interest created by the property adjustment order.²⁶

A property adjustment order can still be set aside as a transaction at an undervalue and/or a voidable preference etc. Express provision is made for this in s39 *Matrimonial Causes Act 1973*, which provides that a property adjustment order in matrimonial proceedings is capable of constituting a transaction at an undervalue.

For further information as to the inter-action between matrimonial proceedings and bankruptcy, see SGH Keynotes on this subject.

²² ss339-340 Insolvency Act 1986

²³ pursuant to s423 Insolvency Act 1986

²⁴ *Beer v Higham (A Bankrupt)* 1997 BPIR 349

²⁵ *Mountney v Treharne* 2002 EWCA Civ 1174

²⁶ in view of the construction of s283(5) Insolvency Act 1986. The decision in *Mountney v Treharne* was based on *Re MacLurcan* 1897. It is highly arguable that the line of reasoning in *MacLurcan* is capable of being overturned, although the Court of Appeal considered that it was bound by this historic judgment in *Mountney v Treharne*. Indeed in *Mountney* Mr Lord Justice Parker overruled his own earlier judgment in *Beer v Higham*, although leave to appeal to the House of Lords was granted by the Court of Appeal in *Mountney*. A petition to the House of Lords was not filed in *Mountney v Treharne*, as by that stage it had become apparent that even if a further appeal was successful no realisations would ultimately be made for the benefit of creditors.

6. Realising the Trustee's interest

Once the bankrupt's interest in a matrimonial home has been calculated, the next step is usually to ascertain whether or not the bankrupt's spouse is able to purchase the Trustee's interest.

Independent FRICS valuations, and up-to-date redemption statements, will need to be obtained – so as to establish the amount that ought to be capable of acceptance (taking into account Estate Agent's commission, costs of sale etc).

Care should also be taken insofar as concerns rented accommodation, or investment property. I have in mind that, in respect of rented property, the Trustee would be entitled to a share of any rental income derived post-bankruptcy - although allowance should be made for any payments towards the mortgage and upkeep of the rented property (including, for example, management fees etc).

If the bankrupt is unable to dispose of his interest to the non-bankrupt spouse, consideration will have to be given ultimately to apply for an order for sale pursuant to s14 Trust of Land & Appointment of Trustees Act 1996 & s335A Insolvency Act 1986.

Upon such an application, where more than one year has elapsed since the vesting of the estate in the Trustee (i.e. not one year from the commencement of bankruptcy), in the absence of exceptional circumstances the interests of the creditors will outweigh all other consideration.

It should be noted that ss335A and 336 Insolvency Act 1986 only apply to spouses and former spouses. No protection is given directly by these sections of the insolvency legislation to co-habitees²⁷. Nevertheless the writer's view is that, notwithstanding the legislation, the Court will '*fall over backwards*' to afford the same measure of protection to co-habitees as to spouses – in view of the changes in society since the introduction of the legislation.

An order for sale can currently be obtained by a Trustee where ultimately the realisations that will be made will only be used to meet the costs of the bankruptcy, and it is highly likely that no dividend will be paid to creditors.²⁸ This will no longer be the case following the introduction of the personal provisions of The Enterprise Act 2002 – see below.

Where there are exceptional circumstances (within the meaning of s335A Insolvency Act 1986) an order for sale can be postponed for either a finite period of time or indeed until a specified event takes place. An order for sale can theoretically be postponed, where exceptional circumstances exist, where/until:

1. the bankrupt's children have completed their education²⁹;
2. the death of an infirm relative residing at the property, where it is demonstrated that forcing the relative to move would have an adverse affect on his/her health³⁰;
3. the bankrupt's spouse has suffered, for a long period of time, from mental illness, and evidence establishes that moving property (usually to a less

²⁷ *Re Sharpe* 1980 1 WLR 219

²⁸ *Harrington v Bennett* 2000 BPIR 630. The decision in this case ought to be contrasted from the position upon the application of an income payments order under s310 Insolvency Act 1986 – where a benefit to creditors must be demonstrated.

²⁹ *Re Holliday* 1981 Ch 405

³⁰ *Re Mott* 1987 Cly 212

suitable premises in a different area) would be likely to cause a relapse in a patient's condition³¹.

When considering exceptional circumstances, it is important to insist upon an independent consultant's medical report confirming the ailments from which a co-habitee suffers, and moreover expressly stating what the effects would be on these conditions were the said co-habitee to be forced to move property. Usually the co-habitee seeks to adduce a letter from his/her General Practitioner, which in the writer's view is insufficient.

It ought also to be remembered that the bankrupt's wife will enjoy statutory rights of occupation, as indeed would a bankrupt who occupies a property with children under the age of 18 years.³²

If the Trustee is unable to obtain an order for sale, for whatever reason, the Trustee may apply to obtain a charge on the property for the benefit of the estate pursuant to s313 Insolvency Act 1986.

Where an estate in bankruptcy includes an interest in a dwellinghouse occupied by the bankrupt (or his spouse or former spouse), and this interest has not been realised, a final meeting of creditors cannot be convened until after an appropriate certificate has been obtained from the Secretary of State, or s313 charge placed on the property.³³

³¹ *Re Ravel 1998 BPIR 389*

³² *s337 Insolvency Act 1986*

³³ *ss331-332 Insolvency Act 1986*

7. Human Rights & The EU Insolvency Regulation

When it came into force, it was feared that the Human Rights Act 1998 would provide a useful tool to non-bankrupts seeking to avoid an order for sale being made in respect of a property falling within the estate. Article 8, Schedule 1, of the Act provides a right to respect for private and family life, and the family home.

In practice, the Human Rights Act 1998 has not been invoked successfully against a Trustee in Bankruptcy. This is primarily as a result of the public policy exemptions afforded by the Act.

Furthermore, although the Human Rights Act 1998 provides a right to respect for private and family life, the family home and correspondence, these terms are not defined by the Act. The writer's view is that the '*family home*' is distinguishable (over and above the public policy exemption) from the family dwellinghouse. The writer's view is that the *family home* protected by the Act is constituted by social and personal connections between the co-habitees, whereas the dwellinghouse (which forms the subject-matter of an application for an order for sale) is merely bricks and mortar. One could argue that, were a bankrupt and his wife be forced to move property, the '*family home*' protected by the Human Rights Act would be forced to relocate with them.

In *Karia v Franses*³⁴, the bankrupt's wife appealed an order for sale relying on Human Rights arguments. The appeal was dismissed.

Human Rights issues were also considered in *Jackson v Bell & Another*³⁵. Although the application was originally dismissed, the Court of Appeal subsequently granted leave to appeal. So far as the writer is aware, an appeal was never progressed. One presumes that a settlement was concluded, but this case should nevertheless be viewed as a '*note of caution*'. It may indicate, bearing in mind the leave granted by the Court of Appeal to appeal to the House of Lords, that Human Rights issues may again be raised in the future - and ultimately be considered by the highest Court within the jurisdiction.

A Trustee in Bankruptcy ought also to bear in mind the EU Insolvency Regulation³⁶. Although the same will not directly affect the Trustee's interest in the matrimonial home, it creates a distinction between Main and Secondary/Territorial Insolvency Proceedings (depending on whether the debtor has his Centre of Main Interest, or an Establishment within the jurisdiction where the bankruptcy order is made). If the bankruptcy proceedings constitute Main Insolvency Proceedings, the realisation of assets abroad (within the EU, save for Denmark) ought to be simplified – through the mutual recognition of insolvency proceedings, between Member States, provided for in the EU Insolvency Regulation. For further information, see SGH's Keynotes on European Insolvency Regulation.

³⁴ *Chancery Division, 12 November 2001 (BLD 131 101 3709)*

³⁵ *2001 EWCA Civ 387*

³⁶ *SI No. 1346 of 2000, which came into force on 31 May 2002*

8. The Enterprise Act 2002 – Matrimonial home provisions

Under the current legislation all of the bankrupt's estate permanently vests in his Trustee in Bankruptcy³⁷. This includes any interest that the bankrupt may have in the matrimonial home, or a former matrimonial home. It is not unheard of for cases to be referred, by the Protracted Realisations Unit, to insolvency practitioners 8–10 years after a bankruptcy order has been made. In view of recent trends in the property market, where previously there was little/no equity in a property, when the matter has been referred to an insolvency practitioner, it is not unusual (8–10 years later) to find that the bankrupt's property has a significant level of positive equity. During the intervening period the bankrupt, or his/her family, would have been making payments towards the mortgage, although this does not serve so as to reduce any interest that the Trustee in Bankruptcy may have in the matrimonial home³⁸.

Such situations prompted a number of complaints to members of Parliament. The Government's original proposals for reform of the bankruptcy regime did not include any reforms concerning realisation of the matrimonial home. An appropriate clause was only tabled during the committee stages in the House of Commons, largely as a result of representations made by the Insolvency Practice Council, the Bankruptcy Advisory Service, and the Association of Business Recovery Professionals.

The Three Year Rule – 'Use it or lose it'

By way of introduction of s283A Insolvency Act 1986 provision is made effectively compelling a Trustee in Bankruptcy to deal with the matrimonial home within a period of **three years** beginning on the date on which a bankruptcy order is made.

The three-year rule ***applies to*** a bankrupt's ***interest in a dwelling house***, which as at the commencement of bankruptcy, was a ***sole or principal resident of*** :

- a) the ***bankrupt***,
- b) the bankrupt's ***spouse***; or
- c) a ***former spouse*** of the bankrupt.

If the Trustee forms the view that a property is subject to the provisions of s283A Insolvency Act 1986, he is ***obliged to issue an appropriate notice*** to all interested parties notifying them of his decision pursuant to Insolvency Rule 6.237. Such notice must be issued no less than 14 days prior to expiry of the three-year period.

If within the aforementioned three-year period, a Trustee in Bankruptcy fails to deal with such an asset, the proprietary interest in question (i.e. the bankrupt's interest in the property) ***automatically re-vests in the bankrupt***³⁹. Upon such re-vesting, and within seven days thereof, the Trustee is obliged to notify HM Land Registry that the interest has re-vested in the bankrupt (or to provide an appropriate certificate as to re-vesting on Form 6.84 in the case of unregistered land)⁴⁰.

As aforesaid the three-year rule only applies to properties at which the bankrupt, the bankrupt's spouse, or the bankrupt's former spouse ***reside*** (as their sole or principal residence) ***as the date of the bankruptcy order***. The three year use it or lose it rule will therefore not apply to investment property. It is however conceivable that the three year rule may apply to more than one property, where for example the bankrupt resides at one

s306 Insolvency Act 1986

³⁸ Since payments to the mortgage are offset against the occupational rent that the Trustee would otherwise be able to charge for allowing the bankrupt and his family to remain in occupation following bankruptcy (*Re Gorman*)

³⁹ s283A(ii)(b) Insolvency Act 1986

⁴⁰ Insolvency Rules 6.237(a) – 6.237(b)

property, and the bankrupt's former spouse resides at another (but both properties are jointly owned).

If the bankrupt does not inform the Official Receiver or Trustee of his interest in a qualifying property within three months of the commencement of the bankruptcy, the three-year rule will commence to run from the date that the Official Receiver or Trustee becomes aware of such an interest⁴¹.

Transitional provisions

The use it or lose it three year rule will not have retrospective effect. Notwithstanding this the relevant provisions will still apply to existing bankruptcies where a bankruptcy order has been made prior to 1 April 2004 (the day upon which the personal provisions of the Enterprise Act 2002 are due to come into force).

Insofar as concerns *pre-commencement bankruptcies*, the bankrupt's interest in a qualifying property will *re-vest in the bankrupt automatically after the expiry of a three year transitional provision, which commences to run on 1 April 2004* (i.e. re-vesting will take place on 1 April 2007).

Personal liability

If a Trustee in Bankruptcy fails to take steps to realise the bankrupt's interest in a qualifying property, within the three-year rule, and consequently the proprietary interest re-vests automatically in the bankrupt, a Trustee may be faced with a claim against him by the creditors should the estate in bankruptcy have suffered a loss⁴²

Preventing re-vesting of the proprietary interest in the bankrupt

During the three-year period, the Trustee may prevent a qualifying proprietary interest re-vesting in the bankrupt automatically, at the expiry of the relevant three-year period, by taking one of the following five prescribed steps:

1. realising the bankrupt's interest in the property (i.e. selling the same, or concluding a settlement);
2. applying for an order for sale pursuant to s335a Insolvency Act 1986⁴³;
3. applying for an order for possession of the dwelling house pursuant to s336 Insolvency Act 1986;
4. applying for a charge on the property, for the benefit of the bankrupt's estate, pursuant to s313 Insolvency Act 1986; and/or
5. by the Trustee and the bankrupt agreeing that the bankrupt shall incur a specified liability to his estate (with/without interest from the date of agreement) in consideration of which the interest shall cease to form part of the estate⁴⁴.

⁴¹ s283A(5) Insolvency Act 1986

⁴² pursuant to ss303 and/or 304 Insolvency Act 1986

⁴³ it should be noted that there will be no reduction in the period of one year, beginning with the vesting of the bankrupt's estate in the Trustee, insofar as concerns the presumption or assumption that the interests of the creditors outweigh all other considerations upon an application for an order for sale.

⁴⁴ S283A Insolvency Act 1986, as amended by the Enterprise Act 2002

Insofar as concerns the Court applications referred to above, the **suspension of the three-year rule will take effect upon the date of issue (and not the date of the order)** of the requisite application.

The legislation also provides that an application can be made by the Trustee, to Court, to defer/suspend the three-year rule. Such an application could conceivably be made, for example, where due to the late stage at which a Trustee has been appointed he has had insufficient time to investigate the bankrupt's affairs, and in particular the extent of the bankrupt's proprietary entitlement in a particular property.

Charge over bankrupt's interest

The Enterprise Act 2002 also seeks to limit the scope of s313 Insolvency Act 1986, so as to limit the value (as to quantum) of the charge obtainable by a Trustee.

The relevant amendments are intended to prevent the Trustee from recouping the benefit of any increase in the value of the property after the date that the s313 charge is made by the Court. Under the new provisions the value of the charge will be **limited to the value of the bankrupt's interest** in the property **as at the date of the s313 order** creating the charge, **together with interest** accruing thereafter at the prescribed rate under the Judgments Act 1838 (the judgment rate being fixed at that in force on the day that the charge is imposed)⁴⁵.

Minimum level of net equity

Through the insertion of a new s313A Insolvency Act 1986, an **order for sale or a charge** in respect of a property falling within the ambit of s283A Insolvency Act 1986 **shall not be made if the value of the net equity in the property** (as to the bankrupt's interest) **is below the prescribed amount**.

This provision is intended to prevent the realisation of a bankrupt's interest in a property, where there is minimal value as to the bankrupt's share (and consequently where there is likely to be no benefit to creditors in realising the same). Under current case law, even if all the net equity available would only be used to pay the Trustee's costs, an order for sale can still be made⁴⁶.

It had been hoped that the prescribed limit (i.e. the minimum level of net equity required) would become apparent following publication of the secondary legislation. Unfortunately the same contains **no reference to the prescribed limit, and the same is still not known**. It is the accepted view that it is highly likely the Government will in effect introduce a form of formula whereby they would allow the Court to determine what in their view it is just and equitable in the circumstances. It is therefore not necessarily the case that the prescribed limit will be a specified financial threshold (e.g. £10,000, £20,000 etc).

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SGH Sprecher Grier Halberstam LLP
30 Farringdon Street
London EC4A 4HJ

Tel: 0207 544 5555

Email: daniels@sqhlaw.com

⁴⁵ Insolvency Rule 6.237(d)

⁴⁶ *Harrington v Bennett*

Summary of Enterprise Act 2002 Personal Insolvency Provisions

