Machins SOLICITORS

INSOLVENCY NEWS

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BANKRUPTCY AND THE FAMILY HOME

In many cases the Bankrupt's principal asset will be his interest in the family home and therefore this becomes the main target for the Trustee in Bankruptcy to focus on in realising the Bankrupt's assets for the interest of the Creditors.

Where the Bankrupt jointly owns the property, commonly with a spouse, the Trustee will look to sell the Trustee's interest in the property to that co-owner. However, if agreement cannot be reached in that regard, the Trustee will usually then look for an Order for possession and sale of the property through the Courts.

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The Trustee’s financial interest in the property can, on occasions, be tricky to determine and the Courts will consider equitable principles to make sure that the outcome is fair and reflective of the contributions made by parties that have an interest in the property. This is known as ‘equitable accounting’. There will be a number of factors taken into account in this regard. They include the amount the parties have contributed towards the purchase of the property by way of deposits, or contributions that have been made via mortgage repayments. If the property has been extended or improved, which has increased the value of the property, this should also be taken into account. The Courts will often determine the parties’ interests by way of a Declaration often following an application under the Trust of Lands and Appointment of Trustees Act 1996 (frequently referred to as ‘TOLATA’).

In 2007, the House of Lords (which is the highest court in England and Wales, now known as the Supreme Court) set out the accounting exercise which should be followed in TOLATA applications which are very similar to equitable accounting principles. The case, Stack v Dowden, has become one of if not the most important case when dealing with trusts of property in TOLATA cases such as these. Although more recent decisions following Stack v Dowden have stated that the statutory framework set out in TOLATA is not exhaustive and held that the Courts can use their discretion to undertake equitable accounting in appropriate circumstances, it has been confirmed that equitable accounting is aimed at achieving justice between the co-owners and prevent one co-owner from obtaining a windfall.

Where the co-owners have separated and one party has vacated the property, and stops contributing towards the mortgage repayments and the other remaining co-owner continues to repay the mortgage and outgoings in full, the Courts will normally take into account and give credit for the capital repayment element of the mortgage payments, and may use its discretion to give credit to the interest element as well as if repayments have prevented repossession by the mortgagees.

The party that has vacated the property may claim that the party that has occupied the property should have their occupation reflected by way of occupational rent as they have had the exclusive benefit of the property, and it would be equitable and fair to take this into consideration. This argument is based on the fact that the occupier would have had to pay rent had it not been for both parties’ share in the property, and the occupier has obtained a benefit in being able to stay in the property. Each case will depend on the facts when the Court considers what is relevant for occupational rent, but the Court would normally take into account an off-setting position against the mortgage interest payments as a starting point. However, on occasions, expert evidence will be required to consider the open market rental value and the cost of renting alternative accommodation.

The other equitable doctrine which may apply is proprietary estoppel which can arise where one party has acted to their detriment in the belief that they will obtain an interest in the property. The Courts will again consider all the circumstances of the case in endeavouring to achieve a fair and equitable result.

DIRECTORS PERSONAL GUARANTEES

A Directors Personal Guarantee may be requested by a lender when providing credit or by a landlord upon completion of a commercial lease. This enables them, upon default by the company, to seek payment of the outstanding amount from the Director party to the agreement.

Personal Guarantees mitigate risk to the lender. As a result, the director party to the Personal Guarantee accepts this risk. This may enable the company to borrow more, and could be an attractive solution where the director is confident in the company's ability to pay it back.

Directors can request to limit their liability within the Guarantee document. The higher the loan value and the higher risk the company poses in being unable to redeem the loan, the harder this limiting will be to negotiate. In some scenarios where a Guarantee is requested of a director, the Guarantee will be particularised as 'secured'. As a result, the director(s) party to the agreement will be required to offer their home as security.

Please also note that where a Personal Guarantee has been limited to a set value, usually in addition costs and interest will be on top of this limit.

In agreeing to a Personal Guarantee, the directors are sacrificing the limited liability benefit that limited companies offer. In the event that the Personal Guarantee document includes numerous directors, the directors are jointly and severely liable. As a result, the lender/landlord with the benefit, on default, can opt to pursue one or multiple directors for the full amount owed.

There are certain formalities to follow when a Personal Guarantee is being entered into. Under the Statute of Frauds Act 1677, a Personal Guarantee must be in writing.

Also, the lender will often require the Director to obtain independent legal advice to make sure the Guarantee isn't being entered into by the Director by duress or undue influence. This is even more relevant if the Director's spouse or other family member is being asked to offer a Personal Guarantee.

In any event, the decision to agree to a Personal Guarantee should not be taken lightly and financial and legal advice should be sought – even where you're confident in the company's future.

Finally, it is important to consider whether enforcing a Personal Guarantee can be affected by the Breathing Space Regulations (referred to in a separate article in this newsletter). The Government Guidance states "While Guarantor loans can be included in a Breathing Space, the protections do not extend to the Guarantor. The Guarantor can apply for their own Breathing Space, if they are eligible." However, you would also have to consider whether the debt is a qualifying debt under the Breathing Space Regulations.

BREATHING SPACE

Both the Financial Conduct Authority (FCA) and The Insolvency Service have published guidance on the Debt Respite Scheme (Breathing Space). This is to assist and protect people with debt issues from creditors.

There are two types of Breathing Space schemes:-

·A standard Breathing Space.
·A Mental Health Crisis Breathing Space.

Standard Breathing Space

A Standard Breathing Space is available to anyone with debt problems. It will give the debtor 60 days legal protection from creditors. The protection includes pausing most enforcement actions and contact from creditors and freezing most interest and charges on their debts.

Mental Health Crisis Breathing Space

This is only available to someone who is receiving Mental Health Crisis treatment. The protections are stronger than the Standard Breathing Space. It lasts for the length of the person's Mental Health Crisis treatment plus 30 days.

Creditors

If a creditor is told that a debtor is in a Breathing Space, the creditor must stop all actions relating to the debt and respect the protection given to the debtor. The protection will stay in place until the Breathing Space ends.

Commencement of a Breathing Space

A Breathing Space can only be started with the approval of one of the following individuals or bodies:-

1. A debt advice provider who is authorised by the Financial Conduct Authority (FCA) to offer debt counselling.
2. A local authority, where they provide debt advice to residents.
3. An Approved Mental Health Professional (AMHP) certifying that a person is receiving Mental Health Crisis treatment. This evidence can be used by a debt advisor to start a Mental Health Crisis Breathing Space.

Debtor's eligibility for a standard Breathing Space

For a debtor to be eligible for a standard Breathing Space, the debtor must meet certain conditions. The debtor must:-

1. Be an individual.
2. Owe a qualifying debt to a creditor. Qualifying debts include credit or store cards, personal loans, payday loans, overdrafts, utility bills, mortgage or rent arrears. However, the following are excluded debts: (i) Secured debts like mortgages; (ii) Debts incurred from fraud or fraudulent breach of trust; (iii) Fines imposed by a Court Order; (iv) Child maintenance; (v) Student loans; (vi) Council Tax liabilities that have not yet fallen due.
3. Live in England or Wales.
4. Not have a Debt Relief Order (DRO), be in Individual Voluntary Arrangement (IVA), an interim Order or be an undischarged bankrupt at the time they apply.
5. Not already have a Breathing Space or have had a standard Breathing Space in the last 12 months at the time they apply.

The debt advisor must also be satisfied that the debtor meets the following two conditions:-

1. Their client cannot or is unlikely to be able to repay all or some of their debt.
2. A Breathing Space is appropriate for the debtor.

Debtor's eligibility for a Mental Health Crisis Breathing Space

The debtor must still meet the same criteria as for a standard Breathing Space, but they must also be receiving mental health crisis treatment at the time the application is made. A debtor who has a standard or Mental Health Crisis Breathing Space in the last 12 months may be eligible for a Mental Health Crisis Breathing Space.

If someone is thinking of applying for a Breathing Space, they should seek the professional advice of an FCA regulated debt advisor.

CORPORATE INSOLVENCY - REVIEWABLE TRANSACTIONS

In this article, reference to sections relate to the relevant section in the Insolvency Act 1986.

Once a company goes into a formal insolvency, the office holders' duties would include reviewing any transactions which may be recoverable. These include the following:-

·Transactions at an undervalue (Section 238);
·Preferences (Section 239);
·Transactions defrauding creditors (Section 423);
·Contributions from past Directors and shareholders (Section 76).

This article will summarise each in turn.

Transactions at an undervalue

A Liquidator or Administrator may make an application to the Court for a transaction to be set aside on the basis that the transaction was at an undervalue pursuant to Section 238. The Court has wide powers either to set aside the transaction or to make an order as they see fit.

This would apply where:-

(a) the company makes a gift or receives no consideration, or entered into a transaction for significantly less than its true market value; and
(b) the transaction has occurred within the two years prior to the company's formal insolvency; and
(c) the company was insolvent at the time of the transaction.

Preferences

A preference is where the company make a payment and by doing so makes that creditor 'better off' than they would have been if the company went into a formal insolvency.

A Liquidator or Administrator can make an application to the Court to set aside or vary, as the Court sees fit, pursuant to Section 239. The applicant would also have to show that the company was influenced in deciding whether to give the preference, ie the Directors authorising the payment knew that the recipient would be in a better position as a result of the payment. This is presumed for parties associated to Directors or parties associated to Directors.

With regards to how far back the transaction can be from the date of formal insolvency, the transfer would have to be within six months, before the date of the formal insolvency or two years where the recipient is connected with the company.

For all transactions and in all cases the company was insolvent at the time of the transaction.

Transactions defrauding creditors

The heading of Section 423 is "Transactions defrauding creditors", although the main text of the section does not actually use the words 'fraud' or 'defrauding creditors'.

The test under this section is whether the transaction was an undervalue and whether the purpose of that transaction was to put assets beyond the reach of a creditor or to prejudice a person's interest in a potential claim.

The test that the Court applies is a subjective test. The Court has to be satisfied that the person actually had that purpose or intention (which is in contrast to an objective test, where the court would be looking at what a reasonable person in that position would have intended)

Unlike for the other provisions, there is no requirement that the company needs to be insolvent at the time of the transaction.

Contributions from past Directors and shareholders

Where a payment has been made out of capital by a private company for a redemption or repurchase of shares and the company goes into insolvent liquidation within a year of that payment, an application to the Court may be made by any person who has contributed an amount to the company's assets under Section 76.

If you would like to discuss or need any help or support on any of the issues above then please contact the Insolvency Team on 01582 514 000.

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