Home is where the money is

The worsening economic climate brings with it the increasing prospect of greater number of bankruptcies, but Simon Hill says debtors can negotiate postponement of the sale of their homes and other assets

WHERE SOMEONE IS made bankrupt, the family home will often be the main, and sometimes only, asset available to realise and distribute to the creditors. Trustees in bankruptcy are likely to seek an order for possession and sale of the home, applying under s 14 Trusts of Land and Appointment of Trustees Act 1996, or s 33 Family Law Act 1996 (depending on how it is owned and occupied, for example with children or with others having home rights).

Statutory test

Special rules in the Insolvency Act 1986 (s 313A; s 335A – s 337) govern how the court approaches whether to order possession and sale of a home. Under each section, the court must make such order as it thinks 'just and reasonable' having regard to:

- the interests of the creditors;
- the conduct of a current or former spouse/civil partner (if any) so far as contributing to the bankruptcy;
- the needs and financial resources of a current or former spouse/civil partner (if any);
- the needs of any children; and
- all the circumstances of the case, other than the needs of the bankrupt.

Mandatory assumption and exceptional circumstances

However, where such an application is made 12 months after the property has vested in the trustee, the court must assume, unless the circumstances are exceptional, that the interests of the creditors outweigh all other considerations. In addition to the obvious hurdle this creates, a consequence is that trustees tend to provide a one-year 'breathing space' to the bankrupt and his family, sometimes enabling them to make alternative living arrangements. This assumption influences further: the 12-month 'line in the sand' guides courts on how to balance the competing interests, even where the assumption does not strictly apply (*Martin-Sklan v White* [2007] BPIR 76).

Typically, trustees apply after 12 months has elapsed, and so the first consideration will usually be whether 'exceptional' circumstances are made out. The classic test adopted from *Re Citro* [1991] Ch 142 compares 'normal' circumstances with 'exceptional' circumstances.

The problems faced by families in having to move out of the neighbourhood into less suitable alternative accommodation and schooling are not exceptional. They are the melancholy consequences of debt and improvidence with which every civilised society has been familiar, but it is not just the bankrupt's side where exceptional circumstances can be found; the creditors' position can be exceptional.

However, a finding of exceptional circumstances only displaces the assumption in favour of the creditor. Orders for sale might still be made once the various factors referred to above have been weighed up (*Dean v Stout* [2006] 1 FLR 725).

Balancing the factors

During this balance of competing interests, the court has to weigh up considerations with quite different characteristics and qualities. Contrasting the difficulties occasioned to the bankrupt's family with the difficulties of the creditors is a value judgment.

Naturally, while every case turns on its own facts, and there can be no rigid categorising, significant assistance can be gleaned from previous decisions.

The creditors' interests

In most cases, there is no detailed consideration of the creditors' particular circumstances. It is taken as almost axiomatic that what the creditors want is to be paid their money, and sooner rather than later. A 'conventional weight' is given to the creditors without much in the way of positive or specific evidence as to their particular interests or concerns. Those resisting applications can challenge this however – persuading the court that they should be given less weight (*Nicholls v Lan* [2006] BPIR 1243).

A significant factor for the court is the probability that postponing paying off the debts will not cause any great hardship to any of the creditors. Where it is highly likely that there will be no prejudice, this will very probably be exceptional (depending on militating factors) (*Donohoe v Ingram* [2006] BPIR 417 on *Re Holliday* (a bankrupt) [1981] Ch 405). So where there is a sufficient surplus or cushion of equity between the value of the property, and the predicted debts (with statutory interest thereon) and estate expenses at the proposed sale date, it will very probably be exceptional.

Whether there is sufficient surplus of equity will be affected by any likely depreciation or appreciation in the value of the home. A bankrupt allowing the home to fall into disrepair and so damaging its value can be considered, as can house price inflation or deflation.

When assessing the impact of postponement, the identity, size and, where known, general cash flows of creditors may be taken into account. Institutions such as the Inland Revenue or banks might not be thought to be so short of money as to be undermined by delay (though query whether this still holds, given the credit crunch).

A favourable rate of statutory interest for creditors, as compared to standard deposit account rates, during the period of postponement will be taken into account.

Even where all the realised money will be swallowed up by the costs of the bankruptcy, a sale will still be in the creditors' interests (*Harrington v Bennett* [2000] BPIR 630). As far as possible, creditors will want the expenses of the bankruptcy discharged out of the assets of the bankrupt.

Ill health of a spouse

The serious ill health of a spouse led to findings of exceptional circumstances in four important cases: Physical ill health in *Judd v Brown* [1997] BPIR 470 (cancer) and *Claughton v Charalamabous* [1998] BPIR 558 (chronic renal failure and osteoarthritis); and mental ill health (schizophrenia) in *Re Raval* [1998] BPIR 389 and *Nicholls*.

Such serious illnesses (acute or chronic) typically create problems of a very different character from such difficulties as obtaining alternative accommodation or arranging schooling. Consideration will be given to the diagnosis, prognosis and length of any treatment, as well as the loss on sale of any special home modifications (for example stair lifts) or community support in the area.

In *Judd*, critical to the decision to refuse the application was the damage that the stress and loss of security from an eviction would have on the spouse's chances of recovery from cancer. Similarly, in *Raval* and *Nicholls*, the court had to weigh up the risk that eviction would lead to relapses.

Bankrupt's health

The bankrupt's ill heath is not directly relevant to the application as the bankrupt's needs are expressly excluded by the 1986 Act from consideration. However, in *Re Bremner* [1999] 1 FLR 912 the court recognised the wife/carer had an independent need to remain in the property to care for her terminally ill bankrupt husband, which could be taken into account.

Children's well-being

The bankrupt's children's safety and emotional well-being were very significant factors in *Martin-Sklan*. The bankrupt and his chronically alcoholic partner had two girls, aged 10 and 14. From time to time, their mother would leave the home without notice for several days to indulge in a period of alcoholism, leaving the children anxious as to her whereabouts and safety. On returning, perhaps the worse for drink, domestic incidents might occur leading to the children seeking refuge with neighbours or other family members. The girls' well-being and welfare was protected by a delicate combination of their father, their home and a long-established support network of close neighbours, relatives and their schools.

Living close to neighbours who understood the family's problems without need of explanation and who could provide refuge to two young girls on their own quickly, what time of day or night, was 'priceless' and 'almost impossible to replicate'. Substitute accommodation compared very poorly. Eviction was likely to have a seriously negative impact on the children's well-being, educational attainment and self-esteem.

Such circumstances were exceptional, and when the needs of the children were weighed against the interests of three large, cash-rich creditors who had the benefit of a good rate of statutory interest and a comfortable cushion of equity protecting them, possession and sale was postponed for seven years, until the youngest child was 17 years old.

The disruption to a child's educational special needs was unsuccessfully argued to be exceptional in *Barca v Mears* [2005] BPIR 15. A reduced ability to help with homework during staying contact was not enough (also *Re Karia* [2006] BPIR 1226).

Delayed applications

In principle, a significant period between the bankruptcy order and the application for sale can be capable of amounting to exceptional circumstances (*Foyle v Turner* [2007] BPIR 43). But to do so, it would have to: (1) be inordinate; and (2) materially and disproportionately affect some interest to which the court is directed to have regard. In *Foyle*, allowing rising house prices to eliminate initial negative equity over a 13-year period was justified – neither aspect was made out.

Purchasing trustee's interest

An order for sale can be avoided where the bankrupt's spouse (or relative) purchases the bankrupt's former share in the home. Where the spouse doesn't have the money yet, the court might consider postponing sale. In *Re Gorman* [1990] 1 All ER 717 a postponement was granted but only because she had a well-progressed and strong prime facie case against solicitors for negligence (see also *Foenander v Allan* [2006] BPIR 1392). Unissued claims of dubious merit failed to securepostponements in similar circumstances in *Bowe v Bowe* [1997] BPIR 747 and *Jackson v Bell* [2000] All ER (D) 2280.

Further considerations

To properly balance these factors, a valuation of the home will almost certainly be required. In addition, expert evidence will often be required to support any purported medical, educational or welfare consequences from sale. For instance, medical reports were available in *Judd* and *Claughton*, psychiatric reports in *Nicholls* and *Raval*, a social worker report in *Martin-Sklan* and school reports in *Barca*.

The strictness of the mandatory assumption has been challenged on human rights grounds. But after initial 'tentative' obiter comments that the 'narrow approach' of *Re Citro* was inconsistent with Art 8 (Barca), it has been stated in *Foyle* that the Human Rights Act 1998 does not require any modification to the approach set out in the 1986 Act.

Challenges

Aside from appealing, disgruntled litigants can apply under s 375 of the 1986 Act for a review or variation of the order. For instance, where a sale is postponed, an application to vary it could be made, but there would have to be exceptional circumstances – such as new or newly revealed facts, to justify overturning the original order (see *Papanicola v Humphreys* [2005] 2 All ER 418).

There also scope for some postponement, even where exceptional circumstances are not found. A three-month postponement was granted to allow arrangements to be made in *Donohoe* on 'common humanity' grounds.

Increasing relevance

Given that trustees usually wait until 12 months after vesting before applying, any substantial postponement of a sale depends on whether exceptional circumstances are established.

Recent cases help to shed light on the courts' approach to where the line between 'normal' and 'exceptional' exists, both on the side of the bankrupt and on the side of the creditors. As the economic clouds gather, the courts are likely to be asking themselves this question more often.

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