

# Newsletter <sup>2009</sup>



One of the less obvious effects of the recession and property slump, has been the effect on deceased's estates. The fall in property prices is now affecting those entrusted with the task of managing the affairs of insolvent deceased and their estates.

#### The pace of probate

Following the death of a family member, personal representatives ("PRs") will often instruct a firm of Solicitors to deal with obtaining a Grant of Probate and the administration of the estate.

As legal processes go, probate is no greyhound. The administration usually settles into a pace of its own, which can, in some cases, take years to conclude. However, any significant delay is usually tempered by beneficiaries, eager to receive their inheritance. In the good times any delay often resulted in an increase in the estate assets.

#### Slump in property values

How times have changed! Probate practitioners all over the country are now waking up to the fact that earlier valuations of property for probate purposes have since slumped to a worryingly low level.

The value of flats and sheltered housing accommodation, in particular, has fallen further than the market average. Demand for such properties in some areas having almost entirely evaporated.

Times have also changed in that it was common, and, indeed expected by some, that property left by elderly relatives would be free of mortgage. The temptations of modern borrowing, credit cards and equity release schemes have meant that more elderly people are leaving property subject to significant liabilities.

The initial valuation for probate purposes may have fallen to a figure which is either very close to or less than the outstanding mortgage commitment secured over the property.

In some cases the building society/mortgage lender will have, following the death, agreed to a repayment holiday under the mortgage. This was once common, as lenders were confident that there would be more than enough equity. In current market conditions, this only serves to exacerbate the situation, increasing the debt even further.

#### The estate becomes insolvent

As the value of a property falls, the costs and expenses of administering the deceased's estate and the outstanding mortgage liability can mean that there are insufficient funds to meet all the liabilities in the estate.

#### Initial concerns before the property is sold

The executors will need to take great care, before making any attempt to sell the property, to ensure that there will be sufficient surplus, after repayment of all capital and interest liabilities under the mortgage, to meet all other liabilities

(including agent's commission and any other costs arising under the sale).

Determining whether or not a deceased's estate is insolvent, in such circumstances, can be difficult, involving careful consideration of the insolvency tests. PRs should be aware of liabilities arising out of equity release and similar schemes.

#### What should the Personal Representatives do?

Faced with the possibility of an insolvent estate, the PRs may decide to administer the estate in accordance with the law of bankruptcy or, alternatively, an application may be made for an Insolvency Administration Order. Their current Solicitors may consider continuing to wind up the estate, despite the insolvent position, or they may just 'hope for the best'. Tempting as this might seem, they will be required to administer the estate as if in bankruptcy, as it will be subject to the **Administration of Insolvent Estates of Deceased Persons Order 1986**. This would require them to have a detailed knowledge of bankruptcy proceedings. Even if they are able to avoid the traps that await the unwary, they will have to administer the estate without many of the key powers given to a Trustee in Bankruptcy of a living person.

#### Insolvency Administration Order

The alternative is for the executors to apply for an Insolvency Administration Order. This being a rare creature in the world of insolvency, it should not be confused with the corporate administration process. The PRs must have reason to believe the deceased's estate is insolvent in order to present a petition for an Insolvency Administration Order.

#### Protection of the Estate

As soon as it becomes apparent that the estate may be insolvent, the Solicitors and PRs administering the estate should take steps to ensure that no distributions are made pending determination of the matter. If the estate is insolvent and the PRs intend to apply for an Insolvency Administration Order, then they should do so without delay.

#### Section 284 void dispositions

If an Insolvency Administration Order is made, it is deemed to have been made on the date of the debtor's death and takes effect retrospectively from that date.

This means that the provisions of **Section 284** of the **Insolvency Act 1986** will apply in the period from the date of death, rendering all subsequent dispositions void, unless ratified by the Court. The effect of this provision was seen most dramatically in the case of **Re Voss [2008] BPIR 348**, in which payments made out of the estate to Solicitors acting on behalf of PRs were held to be void and, therefore,

*continued on page 4...*

# TUPE issues for Administrators

**Since the Transfer of Undertakings (Protection of Employment) Regulations 2006 ("the Regulations") came into force, insolvency practitioners have had to deal with a number of ambiguities that exist.**

The changes in the Regulations have, to a certain extent, coincided with the rise of the pre-pack administration. This has led to a number of decisions involving both, which provide some guidance as to the interpretation of relevant statutory provisions. This article takes a brief look at some of the recent decisions that are shaping this area of practice.

## Employees dismissed because of lack of funds

Problems dealing with employees following the appointment of an administrator to an insolvent business were highlighted in the case of *Dynamex Friction Limited v Amicus* [2008] EWCA Civ 38. On the same day that the administrator was appointed, he attended the company's workforce and dismissed them, because there were insufficient funds to continue to pay them.

The administrator then attempted to sell the business and was successful in doing so some 8 days later. Both the Union and employees issued claims to the Employment Tribunal. They sought to argue that the effect of Regulation 5 was to transfer their contracts of employment to the purchaser with the business and assets, and that under Regulation 8 the dismissal of the employees by the administrator was connected with the transfer and, therefore, automatically unfair.

## Dismissals fall within "economic" exception

The Tribunal concluded that the employees were not employed by the company immediately before the transfer of the business and assets for the purpose of Regulation 5. The principal reason for their dismissal was an "economic" one insofar as there were insufficient monies to pay wages and, therefore, the dismissal was not automatically unfair.

The Court of Appeal agreed, which came as welcome relief to practitioners, insofar as it provides that administrators may dismiss employees because there are insufficient funds in the administration to pay wages. Such dismissals will constitute an economic reason and will, therefore, be an exception to Regulation 8.

## Don't dismiss to increase saleability

Administrators should not dismiss staff for the purpose of increasing the prospects of being able to sell the business. Nor should they engineer dismissals either on their own account or in collusion with a potential purchaser of the business and assets.

## Pre-pack administration

The Regulations were subjected to detailed scrutiny by the Employment Appeal Tribunal in the case of *Oakland v Wellswood (Yorkshire)Ltd* [2008]JKEAT. It concerned the administration of a fruit and vegetable wholesaler. Administrators were appointed and immediately there was a pre-pack sale of the assets on the same day. The assets

were purchased by Newco, who acquired the lease of the premises, various other assets, and took on 6 of the 7 employees.

## Claim for unfair dismissal

One of the employees brought a claim for unfair dismissal against Newco. At first instance Newco argued that Regulation 8(7) of the Regulations applied. The Regulation states that employees contracts of employment will not transfer to a purchaser under the Regulations where insolvency proceedings have been conducted with a view to liquidation of the assets. The Tribunal agreed and, therefore, the claimant had insufficient continuity of service with Newco in order to pursue a claim for unfair dismissal. The matter came before the Employment Appeal Tribunal.

## The objective of the administration

It was recorded that the Administrators' report had considered the statutory objectives of the administration, as set out in para 3(1) of Schedule B1 of the Insolvency Act 1986. These being, in priority:-

- (a) rescuing the company as a going concern;
- (b) achieving a better result for creditors than if the company were wound up without first being in administration; or
- (c) realising property for secured or preferential creditors.

## Administrators' report

The Administrators had reported that the first objective of rescuing the company as a going concern was not achievable because of the company's insolvency and that they would focus on the second purpose of achieving a better result for creditors than if the company were wound up. They also reported that, due to ongoing losses, any further trading would reduce the assets available to creditors. Therefore, following the pre-pack sale, the company would move from administration to a creditors' voluntary liquidation.

## Procedures with or without a view to liquidation of assets

The Regulations make a distinction between insolvency proceedings that are conducted with a view to the liquidation of the assets and those which are not. Unfortunately, the Regulations do not state which insolvency procedures fall into which category. This has become a matter of interpretation by the Courts.

The effect of Regulations 8(1) to (6) is that where insolvency proceedings are not conducted with a view to a liquidation of assets, certain employee obligations pass to the transferee, subject to the National Insurance Fund meeting certain employee liabilities.

Regulation 8(7) states that where insolvency proceedings are conducted with a view to liquidation of assets then, employment obligations will not pass to the transferee and, therefore, there will be no continuity of employment.

The key question is whether the insolvency procedure is being conducted with a view to liquidation of the assets or not. Previously



Administrators may dismiss employees because there are insufficient funds in the administration to pay wages.... but should not dismiss staff for the purpose of increasing the prospects of being able to sell the business.

## Trustee in Bankruptcy defeats residuary legatee Executor's Solicitors ordered to pay Trustee's costs

the accepted view was that procedures such as bankruptcy, creditors voluntary liquidation and compulsory liquidation were procedures conducted with a view to the liquidation of assets. Administration, voluntary arrangements, administrative receivership and members' voluntary liquidation were not considered to be insolvency procedures with a view to liquidation of the assets.

### Not able to trade administration

In the present case the Employment Appeal Tribunal concluded that it was a question of fact as to whether or not the insolvency procedure was being conducted with a view to liquidation of the assets. In this case, the administrators had recognised that it was not possible to continue to trade the business. They sold the assets and were proposing to enter into creditors' voluntary liquidation ultimately.

### Administration was conducted with view to liquidation of assets

It was held that the appointment of the administrators was with a view to the eventual liquidation of the assets and, therefore, Regulation 8(7) applied. This meant that the claimant did not have his employment rights transferred to Newco and, therefore, he had insufficient continuity of employment to bring the claim.

### Continued trading would have given a different outcome

The Employment Appeal Tribunal also concluded that had the administrators continued to trade, with a view to a sale as a going concern, then any relevant transfer in those circumstances would attract TUPE protection for the employees under Regulation 4.

### Effectively a going concern sale – wrong decision?

Whilst the decision appears to assist administrators in pre-packaging the sale of a business without the burden of employee's liabilities, the reasoning behind the judgment may be subject to a later challenge. The difficulty being that the sale in this particular case had all the trappings of a going concern sale, which meant that in real terms the business continued to trade in the same way as before.

### Buyers face uncertainty

The practical difficulty with the decision is that buyers still face a degree of uncertainty and risk as to whether or not employee obligations will be transferred to the buyer. Therefore, a well-advised buyer may still seek to exploit the uncertainty by reflecting it in the price offered for the assets.

### Importance of Administrators' report

Practitioners should note the emphasis that was placed on the administrators' report to creditors in determining the purpose for which the likely administration was being conducted, the outcome of any continued trading and the choice of exit strategy. A clear and considered report will assist the Tribunal/Court in deciding whether the administration was being conducted with a view to the liquidation of the assets and, therefore, whether or not the Regulation 8(7) applies. ■

***The case of Raymond Saul & Co v Holden & Another [2008] EWHC 2731 highlights the dangers of dealing with a deceased's estate where bankruptcy intervenes.***

Mr Hemming was made bankrupt shortly after his mother's death. The bankrupt was sole Executor and residuary legatee of his mother's estate. The bankrupt and his mother, owned a cottage and a farmhouse in joint names. The cottage had already been sold for £125,000, and the one-half share belonging to the bankrupt had been paid to his Trustee in Bankruptcy. The Executor's Solicitors retained the remaining half as part of the mother's estate.

Although a Trustee in Bankruptcy had been appointed, the bankrupt had received his automatic discharge from bankruptcy. This fact appears to have added to the Executor's Solicitor's confusion in dealing with the Trustee's claim.

### Trustee's request for payment of debts and expenses of bankruptcy

Having already sold the cottage, the more valuable farmhouse remained unsold. The Trustee then wrote to the Executor's Solicitors, requesting that they pay the sum of £28,969 from the monies that they held in the estate, in order to discharge the remaining debts and expenses of the bankruptcy. The Executor's Solicitors, mistakenly as it turned out, refused the Trustee's overtures to discharge the debts and expenses in the bankruptcy.

The Executor's Solicitors argued that the bankrupt, as a residuary legatee, had no legal or equitable interest in any of the specific assets in the estate and would not do so until the administration was completed. On this point they were correct.

### Effect of discharge from bankruptcy not understood

They went further and asserted that the Trustee would not be entitled to the assets forming the residue. This they claimed was because the bankrupt had been discharged from his bankruptcy and that, following discharge, a notice claiming the residue as after-acquired property could not be served under Section 307 of the Insolvency Act 1986. The Executor's Solicitors were intent on paying the residue to the bankrupt direct.

### Litigation

The Trustee's Solicitors requested that the Executor's Solicitors should pay the sum required to satisfy the bankruptcy debts and expenses out of the remaining monies they were holding, suggesting that this would be "infinitely preferable" to forcing a sale of the farmhouse.

The Executors responded by issuing proceedings to determine who the residue of the estate should be paid to. The Trustee issued her own proceedings for possession and sale of the farmhouse. The Executor's

Solicitors and the Trustee's Solicitors both issued court proceedings and took up their respective positions.

### Death of the bankrupt

Before the hearing took place, the bankrupt died and the replacement Executor complained that the proceedings issued by the Executor's Solicitors were "completely unnecessary and pointless". The new Executor went further and questioned why the funds in the estate had not been used to discharge the remaining bankruptcy debts and expenses.

### Increasing costs on all sides

In the interim, the costs claimed by the Trustee and by the Executor's Solicitors had substantially increased and, accordingly, there were insufficient monies remaining in the deceased's estate to discharge the debts and expenses of the bankruptcy without the farmhouse having to be sold. Needless to say, the new Executor also sought justification as to the level of fees and costs incurred by both the Executor's Solicitors and the Trustee.

### Decision in favour of Trustee in Bankruptcy

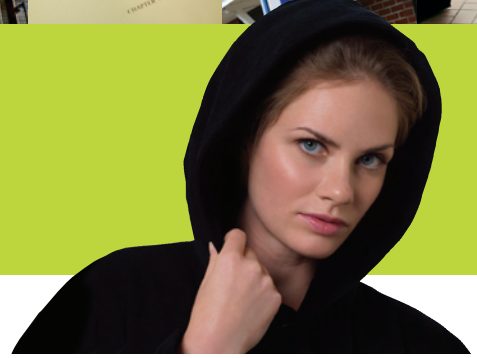
The Judge concluded that until an estate is fully administered, the residuary legatee or a person claiming through him as Trustee in Bankruptcy, does not have any proprietary interest in the specific assets in the hands of the Executors. Mr Hemmings, as residuary legatee had the right to have his mother's estate properly administered and to have the residue paid to him when administration was complete. That composite right was a thing in action which comprised property and, therefore, vested in the Trustee on her appointment.

### Executor's Solicitors should have listened to Trustee in Bankruptcy

Whilst Mr Hemming was alive there was no doubt that he was not willing to accept that the Trustee had a valid claim to the residue of his mother's estate. Regrettably, had the Executor's Solicitors recognised that his entitlement had, in fact, vested in the Trustee in Bankruptcy, then the outcome would have been very different. They should have advised that the Trustee's proposal to discharge the debts and expenses of the bankruptcy out of the remaining funds held in the estate was the only sensible course to take. The consequence of failing to recognise that point meant that the costs incurred increased substantially, on all sides.

### Executor's Solicitors ordered to pay Trustee's costs

The Court went on to find that the Executor's Solicitors had not remained neutral, but had adopted a partisan role. They had acted as a "surrogate" for the Executor against the Trustee in Bankruptcy. The Court ordered that the Executor's Solicitors pay the Trustee's costs themselves, without recourse to the deceased's estate. ■



## Insolvent deceased's estates (cont)

liable to be repaid. The circumstances of that case, although extreme, demonstrate the point quite clearly. Solicitors dealing with an insolvent estate should be wary of continuing to deal with the estate where there is a possibility of an Insolvency Administration Order being made later, for example by a creditor.

### Application for a Validation Order

Whilst it is possible to apply to Court to have dispositions made to Solicitors and others ratified, the procedure is involved and is subject to requirements designed to ensure that the estate is protected and is distributed rateably amongst the creditors.

Each application will be determined on its own merits. However, it is reasonable to deduce from the decision in *Re Voss*, that where Solicitors acting in connection with an estate act quickly, following it becoming apparent that the estate is insolvent, then an application for validation of payments made to professionals, including Solicitors, is likely to stand a greater chance of success than if they continue to act without regard to the insolvency of the estate.

### Limited protection for Personal Representatives

The *Administration of Insolvent Estates and Deceased Persons Order 1986* provides some limited protection to PRs.

In certain circumstances, an Insolvency Administration Order will not invalidate any payment or act made in good faith by PRs before the Order was made. Unfortunately, the provision does not exclude the effect of Section 284 referred to above.

### Insolvency Administration Order – What happens next?

Following the making of an Insolvency Administration Order, the estate will be managed in the short term by the Official Receiver. He will require the PRs, if they have not already done so, to file a statement of affairs relating to the estate.

### Appointment of a Trustee

The Official Receiver may then decide to appoint a Trustee in Bankruptcy, which may either be done by a meeting of creditors or, alternatively, by the Secretary of State. In the case of a Secretary of State appointment, the Official Receiver will make the appointment without holding a creditors' meeting. However, such an appointment will be dependent upon any special circumstances that may exist in relation to the estate or the assets.

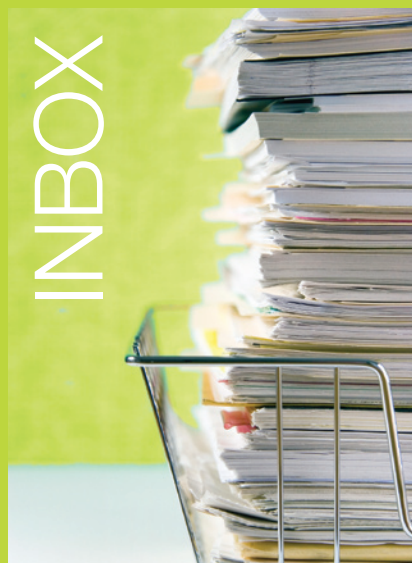
This could be, for instance, where there is a matter or asset that needs to be dealt with as a matter of urgency. In most cases, it is likely that such an appointment will be influenced by the support of major

creditors. In the circumstances described in this article arising out of the fall in property values, it should be remembered that the building society/mortgagee will, where the property remains unsold, have a contingent unascertained, unsecured claim and, therefore, may be a substantial creditor with a significant influence in the appointment process.

### Conclusion

PRs and their Solicitors dealing with estates which contain mortgaged property, or property subject to any conditions under an equity release scheme, should take particular care to assess the immediate position and continue to monitor the solvency of the estate, prior to making any distributions or dispositions, even for costs. Care should be taken not to delay dealing with a potential insolvency whilst waiting for a sale, where the indications from agents are that the property is worth substantially less than the value obtained for probate purposes.

**If there is any prospect that the estate is likely to be insolvent, then advice should be sought immediately.**



### ■ Help! My client has been wound up

If you continue to negotiate with HMRC and other creditors following receipt of a winding-up petition, there is no guarantee that a winding-up Order won't be made. This happened recently to a company running residential care homes. We were able to apply and obtain a rescission of the Order within 7 days, thereby avoiding the need to move the residents to another care home. The application was made possible by the company's bank agreeing to assist in the process with a short-term lending package.

### ■ Transaction at an undervalue claim

We recently acted on behalf of the Trustee in Bankruptcy in connection with a successful claim against a bankrupt's spouse under Section 339 of the Insolvency Act 1986 by way of a transaction at an undervalue.

### ■ After acquired property – extension of time

The time limit for serving a notice claiming an asset as after-acquired property in bankruptcy is a relatively short period of 42 days. We recently advised a Trustee concerning the service of a Section 307 Notice in respect of an asset that had not been claimed previously by a former Trustee. We issued an application for an extension of time, which resulted in an Order being obtained extending the relevant time period within which such a notice can be served.

### ■ Matrimonial home – falling values

Following the collapse in property values, Trustees in Bankruptcy have been left holding property interests with little or no remaining equity. We have been actively advising Trustees concerning different strategies for dealing with such properties in the light of changing market conditions and new case law.