Julian Dobson SOLICITORS

Insolvency Lawyers

NEWSLETTER

Death and creditors

Personal representatives ("PRs") and their professional advisors are more frequently facing claims from beneficiaries and others seeking to challenge the deceased's wishes. An effect of this surge of litigation is that deceased's estates can become insolvent.

Historically insolvent deceased's estates were rare. However, the effects of equity release, care home fees and litigation have meant that increasingly PRs face the challenge of dealing with an insolvent estate resulting in a situation where there are insufficient funds to meet all the liabilities in the estate. In this article we look at some of the issues and risks that PRs have to contend with.

Identifying an insolvent estate

The definition for the purpose of insolvent estates of deceased persons is contained in **Section 421(4) of the Insolvency Act 1986** which provides…*"the estate of a deceased person is insolvent if, when realised, it will be insufficient to meet in full all the debts and other liabilities to which it is subject."* This means that PRs and their solicitors need to be aware of the total debts and liabilities of the estate whilst comparing that to the likely value of the assets within the estate once realised. During the course of administration estate assets can sometimes fall in value. Liabilities can increase as termination fees are incurred and interest added. Ongoing litigation can increase liabilities significantly both in terms of costs incurred and contingent liabilities. Quantifying contingent claims can present difficulties in assessing the effect of a claim against the estate and its solvency/insolvency.

Where it becomes apparent that the estate is insolvent, the PR's must decide how they will deal with it. Deceased's insolvent estates are subject to the **Administration of Insolvent Estates of Deceased Persons Order 1986 ("the Order")** which adapts the bankruptcy regime to apply to the deceased's estate. The Order gives PRs the option of either administering the estate themselves in accordance with the Order or alternatively they, or a creditor, may petition for an Insolvency Administration Order ("IAO").

Should the PRs continue to administer the insolvent estate themselves?

The incumbent PRs and their solicitors may be tempted to deal with the insolvent estate themselves. However, to do so in compliance with the Order requires a detailed knowledge of bankruptcy and for them to act in a similar role to that of a trustee in bankruptcy. Unlike a trustee in bankruptcy, the PRs will not have the powers given to the trustee under the **Insolvency Act 1986** to enable them to administer the estate, and risk personal liability if they get it wrong.

Apply for an Insolvency Administration Order

In cases where the PRs petition the court and obtain an IAO the Official Receiver/trustee in bankruptcy will be appointed to administer the estate. The only ground for the granting of an IAO being that the estate of the deceased debtor is insolvent.

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Key effect of the Order

Perhaps the most important feature of an IAO is that for the purposes of administering the estate, the provisions of the **Insolvency Act 1986** apply as if the IAO had been made on the date of death. This means that the effect of **section 284** is backdated to the date of death and all dispositions in respect of the estate made after the date of death are void unless ratified by the court. This can have serious consequences as was held in the case of **Re Voss [2008] BPIR 348** where solicitors acting on behalf of PRs of a deceased's estate continued to litigate over an extended period of time and to deduct their costs from the estate. Although an extreme example, in that case the court refused to ratify the payments made to the solicitors in their professional capacity. A key factor in that decision was the point at which the PRs should have realised that the estate was insolvent.

Testamentary and administration expenses

The Order provides for the funeral, testamentary and administration expenses to have priority over the preferential debts, remuneration of the trustee and unsecured creditors. There is no definition setting out what constitutes testamentary and administration expenses although guidance can be drawn from the case of **Sharp v Lush (1879) 10 Ch** which held that it includes costs of PRs in performance of their duties. That has since been interpreted as including legal fees of a professional executor **(Re Taylor [1969] 2 Ch 245)**. However, as **Re Voss** demonstrates, it would be imprudent to assume that all legal costs incurred by PRs will be treated as testamentary and administration expenses particularly where conducting litigation after the estate has become insolvent.

Limited protection for PRs

Where a PR who in good faith at a time when he had no reason to believe that the deceased's estate was insolvent pays the debt of any person (including himself as a creditor of the estate) he shall not ….*"if it subsequently appears that the estate is insolvent be liable to account to a creditor of the same degree as the paid creditor for the sum so paid."* **(Section 10(2) of the Administration of Estates Act 1971)**. Further limited protection may be found in the **Trustee Act 1925 Section 61** which provides for the relief of a trustee for a breach of trust to be excused if they acted honestly and reasonably. However, relief is unlikely to be given if the PR fails to distribute the estate in accordance with **section 328** of the **Insolvency Act 1986**.

What happens after the IAO is made?

Once an IAO is made, the Official Receiver will be appointed as trustee in bankruptcy of the deceased's estate. The Official Receiver may subsequently decide to appoint an outside trustee in bankruptcy on behalf of the Secretary of State or where sufficient creditors request, the Official Receiver may appoint a trustee in bankruptcy as nominated by the creditors. From the PRs perspective all responsibility for the estate then falls on the trustee in bankruptcy who will have the task of realising any assets as well as dealing with creditors' claims. Where proceedings have been issued or threatened, the trustee will consider how to deal with the claim and in particular, whether to admit the claim in the estate and if so, for what amount. As part of that process litigation may be stayed.

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Conclusion

PRs and their solicitors should review the potential insolvency of a deceased's estate at regular intervals particularly where there are significant changes in asset values or previously unknown claims become apparent. Particular care should be given to the effect of contingent claims on the solvency/insolvency of the estate. Where it is apparent that the estate is or may become insolvent, then active consideration should be given to the terms of the Order, and in particular whether to apply for an IAO.

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

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