

## **Bankruptcy - A Rare Exception**

*Mark Pawlowski examines the case law on applications for sale of the family home after one year of bankruptcy*

The criteria to be applied to applications made by a trustee in bankruptcy for possession and sale of the family home under s.14 of the Trusts of Land and Appointment of Trustees Act 1996 are currently set out in s.335A(2) of the Insolvency Act 1986 (inserted by Schedule 3 to the 1996 Act). Under s.335A(2), whilst the court must have specific regard to the needs and financial resources of the bankrupt's spouse and the needs of any children in determining what order to make under a s.14 application, it must also consider the interests of the bankrupt's creditors, the conduct of the bankrupt's spouse, so far as contributing to the bankruptcy, and all the circumstances of the case other than the needs of the bankrupt. Significantly also, there is provision in s.335A(3) that, in the absence of "exceptional circumstances", on an application a year after the property vests in a trustee in bankruptcy, the interests of the bankrupt's creditors outweigh all other considerations. This statutory presumption is premised on Parliament's intention to provide a breathing space of 12 months to the bankrupt and/or his family to enable them to make alternative financial or living arrangements.

### **What are exceptional circumstances?**

#### *Wife's medical condition*

Not surprisingly, the courts have accepted that the wife's serious illness may qualify as an exceptional circumstance. In *Judd v Brown* [1998] 2 FLR 360, for example, the wife was undergoing a course of chemotherapy which was likely to continue for five to six months, and she claimed that her chances of recovery would be damaged by stress if the matrimonial home was sold. Harman J, refusing an order for sale, held that the wife's sudden and serious attack of

ovarian cancer was an exceptional event and clearly distinguishable from problems such as organising substitute housing and rearranging children's schooling, which were foreseeable and long-term conditions. Similarly, in *Re Ravel (A Bankrupt)* [1998] 2 FLR 718, the wife had suffered for many years from paranoid schizophrenia and, although she was stable and living at home, her doctor advised her that "adverse life events" (for example, a move to a smaller property away from supportive friends and family) could cause a relapse of her condition. Blackburne J held that the wife's circumstances justified a postponement of the order for sale for one year to enable suitable alternative accommodation to be found for her by the local authority. In his view, six months (ordered at first instance) was insufficient time and postponement of the order for five years (as contended by the wife) would be too long for the creditors to wait for their money. The case is authority for the proposition that the wife's illness does not have to be sudden and short term to merit the exercise of the court's discretion in her favour. Indeed, his Lordship opined that where a person who suffers from terminal cancer but whose life expectancy cannot be judged and whose illness, therefore, could properly be described as long term and of indeterminate duration, could still be characterised as exceptional, justifying no order or, alternatively, a postponement of sale indefinitely.

Again, in *Cloughton v Charalamabous* [1999] 1 FLR 740, the trial judge concluded that the wife's renal failure and chronic osteoarthritis, the latter imposing severe restrictions on her mobility, amounted to exceptional circumstances under s.335A(3) of the 1986 Act. He, therefore, suspended the order for possession indefinitely (in effect, as long as the wife should continue to live in the property), having regard also to the fact that the husband's creditors would receive nothing from the sale of the house of which the proceeds would be consumed in costs. Jonathan Parker J, on appeal, upheld the judge's order, stating that he was entitled to take the view that the wife's health and immobility, with her associated special housing needs and her reduced life expectancy, amounted to exceptional circumstances. His Lordship also held that the terms of the suspension order were essentially a matter for the discretion of the judge and that an appellate court would not normally interfere, unless it was clear that a judge had misdirected himself in law or erred in principle, which had not happened in this case. Ultimately, therefore, the question of what constitutes "exceptional" is largely a value judgment to be left to the trial judge with very little scope for interference at appellate level. In *Hosking v Michaelides* [2004]

All ER (D) 147, however, Mr Paul Morgan QC (sitting as a deputy judge) ventured an actual definition of the word “exceptional” to mean “out of the ordinary course, or unusual, or special, or uncommon”. Here, the wife’s medical condition was such that the loss of the house would be “disastrous” for her and could aggravate her dangerous behaviour both to herself and her children.

By way of contrast, in *Pickard v Constable* [2017] EWHC 2475 (Ch), the district judge was held to have erred in postponing a possession order until the death or earlier permanent vacation of the property by its disabled occupant. No evidence had been provided that the local authority, in line with its statutory duty, would not be able to find the occupant alternative accommodation. The court, therefore, made a sale and possession order, postponed for 12 months, providing liberty to apply to vary the date for possession on appropriate evidence: see also, *Grant v Baker* [2016] EWHC 1782 (Ch), (where it was held that the trial judge was wrong to postpone a sale of property order for a bankrupt's house until the bankrupt's daughter, who had special needs, no longer resided at the property - although the circumstances were exceptional, the judge had failed to give appropriate weight to the point that an indefinite suspension of the sale was incompatible with the underlying purpose of bankruptcy legislation).

An important case which deserves closer attention is *Nicholls v Lan* [2006] EWHC 1255. Applying the meaning of the word “exceptional” in *Hosking*, above, the district judge at first instance concluded that the wife’s chronic mental condition rendered the circumstances exceptional so as to displace the statutory assumption and engage the balancing exercise required under s.335A(2). For the purposes of that sub-section, however, the district judge concluded that there was no relevant conduct on the part of the wife and no children to be considered, leaving only the interests of her husband’s creditors, her needs and financial resources and all the circumstances of the case (except the needs of the husband) to be evaluated in the process of determining what was a “just and reasonable” order.

One special feature of the case, however, was that the wife was also the joint owner of another property that was inhabited by her brother, the other owner. The existence of her joint ownership in this property was potentially significant in two ways. First, it was suggested that she could go

and live at this property with her brother. Secondly, there was the possibility that her interest in the property could be realised and with her share of the proceeds of sale she would have sufficient to buy out the trustee's half share in the equity of the matrimonial home. In the light of this, an open offer was made on behalf of the wife to the trustee, which provided for an order for possession and sale of the home to be suspended in certain circumstances and for a charge to be made over the other property in respect of the bankruptcy debt. This offer, however, was rejected by the trustee largely on the basis that the creditors would not be likely to receive anything towards the payment of the debt in the foreseeable future. In any event, the district judge decided he could not make an order reflecting this offer as it would directly bite on the other property jointly owned by the brother, which was not the subject of the proceedings. Ultimately, the judge ordered that the matrimonial home should be put on the market for sale not earlier than 18 months from the date of the order.

On appeal in the High Court, the deputy judge concluded that the district judge's conclusion that he could not make an order on the terms of the wife's open offer was wrong as he, clearly, did have such jurisdiction. The offer contemplated an order for possession (and sale) of the matrimonial home with suspension of the orders until the happening of specified events. It was, therefore, not dealing with property outside the subject of the proceedings. The next question was whether the district judge had exercised his discretion correctly in making the order he did. In this connection, as mentioned earlier, an appellate court will be slow to overturn the balancing exercise carried out in a lower court unless the trial judge erred in law by leaving out of account relevant considerations or taking into account irrelevant matters or was otherwise plainly wrong in his conclusion. In the instant case, the district judge could not be faulted, particularly in his evaluation of the impact on the wife of her being forced to leave the matrimonial home. The peculiar feature of the case before him, however, was the fact that there was a real expectation that the wife would be able to realise her share in the other property and then buy out her husband's trustee in bankruptcy. Although the consequence of this would be that her brother would lose his home, the effect on the wife herself would not be as devastating as losing her own home. On balance, therefore, the district judge had been right to identify a difference between ordering the wife out of her own home and seeking to promote a solution where she could stay in

the property. A postponed sale for 18 months (in order to give the wife time to pay off the trustee) was, therefore, a just and reasonable solution for both parties.

In *Everitt v Budhram* [2009] EWHC 1219 (Ch), Henderson J characterised the bankrupt's husband as having special needs which brought the case within the exceptional category. The husband was significantly affected in terms of mobility and suffering from severe ailments including the after-effects of a stroke and diabetes. An order for sale was postponed for a minimum period of one year. The case highlights the point that exceptional circumstances cannot include the needs of the bankrupt himself (whether they be financial, medical or psychological) because consideration of his needs is precluded by s.335A(2)(c).

#### *Other personal circumstances*

The cases also suggest that the statutory assumption under s.355A(3) may be displaced where other significant personal and human circumstances exist which override the creditor's purely commercial interest in seeking a repayment of his debt. In *Louise Brittain (the Trustee of the Property of the Bankrupt) v Haghghat* [2009] EWHC 90 (Ch), for example, the wife's oldest son, aged 25, was severely disabled with quadriplegic cerebral palsy requiring continuous care which was provided by her on a daily basis. The deputy judge ordered that the family home be sold, but only after three years so as to allow the family to be rehoused in other accommodation suitable to their needs. In the instant case, the needs of the son were clearly such as to make the circumstances of the case exceptional thereby allowing the court to approach the matter by reference to the various other considerations with a view to making an order which was just and reasonable.

Each case, of course, falls to be considered on its own merits. In *Barca v Mears (Trustee of the Estate of Romano Barca)* [2005] 2 FLR 1, an order for possession and sale was resisted on the ground that it would disrupt the education of the bankrupt's son, who had special educational needs. The son stayed with his father for most days of the week. The father feared that, if he was rendered homeless, the help which he would be able to provide his son would be severely

curtailed and that his son's progress would cease. The deputy judge, however, concluded that the son's problems were not extreme and there was no question of his having to leave his present school since he would be able to live in his mother's home, if necessary throughout the week.

In *Martin-Sklan v White* [2006] EWHC 3313 (Ch), the application for an order for sale was made in just less than 12 months following the vesting of the house in the trustee in bankruptcy. Accordingly, the trial judge did not apply the statutory assumption strictly but, nevertheless, approached the application for sale on the basis that the interests of the creditors were a "very important consideration" in balancing the competing interests of the parties. In this case, the bankrupt's wife was an alcoholic who periodically left the home to indulge in a period of alcoholism before returning. There were issues regarding the safety of the two children and the emotional impact upon them of their mother's chronic condition. Their wellbeing and welfare were being protected by a combination of their father, their home and a long-established support network of close neighbours and local school. The needs of the children could not, therefore, be characterised as usual or typical consequences of the bankrupt's indebtedness. To that extent, the case was exceptional in so far as it involved "a family scarred by the effect of alcoholism" and where "the house sought to be realised was one which had very particular properties so far as the family was concerned, having regard to its position in a community which was supporting the children against their family difficulties". So far as the interests of the creditors was concerned, it was highly unlikely that an appropriate delay in the sale of the property would cause hardship given that there was a sufficient surplus in the value of the property to protect the creditors – indeed, it was evident that they "will do quite well out of leaving their money in the estate of the bankrupt". In the result, the order for sale was postponed for seven years until the youngest daughter reached 17.

#### *Likelihood of recovery of the debt after postponed sale*

In *Donohoe v Ingram (Trustee in Bankruptcy of Ian Charles Kirkup)* [2006] EWHC 282 (Ch), it was argued that the fact that the creditors were likely to be paid in full with statutory interest, even if the order for sale was postponed for a number of years to allow the children to remain in

the property until they were older, amounted to exceptional circumstances. This was rejected by the deputy judge on the ground that there were other circumstances which, taken together, pointed the other way. Much will depend, of course, on the length of the delay in the debt being repaid and the degree of hardship to the creditors who will not receive their money for some considerable time.

### **The human rights dimension**

A separate attack levelled against the deputy judge's approach in *Nicholls*, mentioned earlier, to ordering a sale of the house was that he had given too much weight to the interests of creditors, particularly as there was little evidence as to the actual identity of each of them or the amount of their individual debts. In support of this contention, it was argued that the wife's right to respect for her home under Article 8 in Schedule 1 to the Human Rights Act 1998 should have been fully considered. On this point, however, the deputy judge had no hesitation in concluding that the test in s.335A was not inconsistent with the qualified nature of the rights protected under Article 8. This was because the whole purpose of s.335A(2) was to identify the need to respect the home, but not as an absolute objective to be guaranteed in every case but as a consideration in a balancing exercise. So far as the interests of the debtor's creditors were concerned, it was significant that s.335A merely provided that their interests were to be taken into account without prescribing the weight to be given to those interests. This was, therefore, largely a matter for the judge in exercising his discretion as to what was fair and reasonable.

An Article 8 argument was also raised and failed in *Foyle v Turner* [2007] BPIR 43, where HH Judge Norris QC recognised that the protection of the rights under Article 8 required a balance to be struck between the needs of the individual and the needs of the community and for any interference with individual rights to be proportionate to the legitimate aim pursued. However, in his view, the checks and balances that had to be carried out under s.335A of the 1986 Act before an order for sale could be made, which included looking at the needs of and resources of a non-bankrupt spouse and considering whether exceptional circumstances dictated that the needs of the creditors should not be put first, were similar to those required under the European

Convention on Human Rights 1950. There was, therefore, no need for any separate consideration of Article 8 rights.

The impact of Article 8, however, is not entirely free from doubt. In *Barca*, referred to earlier, the deputy judge suggested that a possible shift in emphasis in the interpretation of s.335A might be necessary to achieve compatibility with a bankrupt's rights under the European Convention on Human Rights. In his view, the provisions of the 1986 Act ought to be regarded as recognising that, in the general run of cases, the creditors' interests would outweigh all other interests, but leaving it open for a court to find that, on a proper consideration of the facts of a particular case, it was one of the exceptional cases in which that proposition was not true. The trend of the case law has been not to require the operation of a different exercise from that adopted in the strict wording of s.335A(3). In *Ford v Alexander (Trustee of the Estate of the Appellants)* [2012] EWHC 266 (Ch), for example, Peter Smith J expressly held that the requirements in s.335A(2) and the change of emphasis in s.355A(3) did not infringe Article 8 of the Convention. In his view, they already provided an appropriate balance as between the rights of creditors and the respect of privacy and the home of the debtor: see also, *Re Karia* [2001] WL 1560733.

The conclusion, therefore, that the requirements as set out in s.355A do not infringe Article 8 rights finds general support in the English case law. The courts continue to apply the same test as applied in the pre-1986 decisions on bankruptcy, so that exceptional circumstances must, in the words of Nourse LJ in *Re Citro* [1991] Ch 142, 157, fall outside the "normal melancholy consequences of debt and improvidence".

## **Conclusion**

One rationale for favouring the commercial interests of the creditor is that the trustee in bankruptcy is statutorily bound, under s.305(2) of the 1986 Act, to realise the assets of the bankrupt leaving him with little choice but to proceed with an application for an order for sale of



the family home. Coupled with this is the judicial notion, reflected in much of the English case law, that commercial agreements should be honoured and respected.

What emerges, therefore, is a model premised on the principle that the interests of creditors will invariably prevail over family concerns unless there are compelling reasons for refusing (or deferring) sale which are absent from the ordinary run of cases. The model adopted is one which advocates the notion that “money talks” so as to deprive the family of its home because the borrower must honour his debts above all else. Despite, therefore, the initial adoption of a seemingly neutral stance (contained s.335A(2) of the 1986 Act) of requiring the court to engage in a balancing exercise of the competing interests of creditors against the welfare of the family and the needs of the bankrupt’s spouse in determining what order to make within the first year of bankruptcy, that neutrality is then abandoned by a statutory presumption in favour of creditors (contained in s.353A(3)) after one year of bankruptcy which places the onus squarely on the family to persuade the court that “money should *not* talk” and that personal and family welfare should prevail over a sale of the property. In this commercial model, therefore, the protection of the home as a legal concept is inevitably subordinated to purely financial interests once an arbitrary “breathing space” of 12 months has passed which is intended to enable the bankrupt and/or his family to make alternative financial or living arrangements.

For all these reasons, therefore, there is little hope, in the writer's view, that the English courts will provide any scope for development of Article 8 Convention rights in the balancing of commercial and family interests in the context of a bankruptcy under the 1986 Act.

### **Points for the practitioner**

1. Under s.335A(3) of the 1986 Act, in the absence of "exceptional circumstances", on an application a year after the property vests in a trustee in bankruptcy, the interests of the bankrupt’s creditors will usually outweigh all other considerations.

2. Such exceptional circumstances tend to be confined to the wife's medical or mental condition, although other personal circumstances may be taken into account involving a severe physical, mental or emotional disability (for, example, quadriplegia, cerebral palsy, alcoholism) suffered by a close relative or dependent.
3. Even a sufficient surplus of equity in the house, enough to meet the predicted debt with interest after a postponed sale, may not be enough to bring the case within the exceptional category.
4. The overall conclusion is that the court's discretion to refuse (or postpone) sale is very limited in the bankruptcy cases and the human rights dimension has done little, if anything, to alter that position.

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