

Exceptional circumstances: the current position

KEY POINTS

- This article explores recent case law in proceedings for possession and sale of a bankrupt's home.
- It looks at the evidential burden of proof to establish exceptional circumstances under s 335A of the Insolvency Act 1986.
- Having established that there are exceptional circumstances present, recent cases far more support a sale being delayed for a reasonable adjustment period rather than the creditors rights being suspended indefinitely.

The decision in *Pickard v Constable* [2017] EWHC 2475 (Ch) highlighted the need to satisfy evidential burdens of proof if the court is to grant relief and that the decision making tribunal should not make judgments based on scant evidence from insufficiently qualified individuals. The case concerned the applicability of the exceptional circumstances regime as set out in s 335A of the Insolvency Act 1986 ('the Act').

It is worth putting the law in context generally for a bankruptcy estate. By ss 283 and 306 of the Act, the bankrupt's estate vests in the trustee in bankruptcy who has a duty under s 305 to get in, realise and distribute that estate. Section 283A of the Act created a three-year time limit to make an application to get in any asset consisting of the principal residence of the bankrupt, his/her spouse or former spouse. A failure to do so on the part of the trustee will automatically re-vest the property to the bankrupt unless the court orders otherwise. The time limit can be extended by court order.

The impact of these provisions is that the trustee generally has a limited time period to seek to reach a negotiated settlement for the realisation of the bankrupt's home before an application to court for possession and sale must be made. A failure by either side to engage sufficiently to resolve any issues can cause proceedings to be issued with costs consequences for each depending on the outcome. Often an earlier engagement could result in a settlement but in the real world that early engagement so rarely seems to happen.

THE PROVISIONS OF S 335A Rights under Trusts of Land

(1) Any application by a trustee of a bankrupt's estate under section 14 of the Trusts of Land and Appointment of Trustees Act 1996 (powers of court in relation to trusts of land) for an order under that section for the sale of land shall be made to the court having jurisdiction in relation to the bankruptcy.

(2) On such an application the court shall make such order as it thinks just and reasonable having regard to –

- (a) the interests of the bankrupt's creditors;
- (b) where the application is made in respect of land which includes a dwelling house which is or has been the home of the bankrupt or the [bankrupt's spouse or civil partner or former spouse or former civil partner] –
 - (i) the conduct of the [spouse, civil partner, former spouse or former civil partner], so far as contributing to the bankruptcy,
 - (ii) the needs and financial resources of the [spouse, civil partner, former spouse or former civil partner], and
 - (iii) the needs of any children; and

(c) all the circumstances of the case other than the needs of the bankrupt.

(3) Where such an application is made after the end of the period of one year beginning with the first vesting under Chapter IV of this Part of the bankrupt's estate in a trustee, the court shall assume, unless the circumstances of the case are exceptional, that the interests of the bankrupt's creditors outweigh all other considerations.

(4) The powers conferred on the court by this section are exercisable on an application whether it is made before or after the commencement of this section.

This section is set out in full here because it is often forgotten that the application by a trustee in bankruptcy to realise a jointly owned property is one being made by a beneficiary of a trust to enforce that trust. The intervention of the bankruptcy of one of the co-owner beneficiaries of that trust causes that person's beneficial interest to vest in the bankruptcy estate but the legal interest is unaffected. The trustee in bankruptcy must enforce the trust. The court is required to carry out a balancing exercise under sub-s 2. However, from the first year after the vesting of the asset in the estate, the creditors' rights prevail unless there are exceptional circumstances. This leads many trustees in bankruptcy to wait until the first anniversary of the bankruptcy has occurred before dealing with a property that is jointly owned. This can be unfortunate as it further shortens the period in which an application has to be made owing to the effects of s 283A. It is submitted that, even if there would be no intention to issue an application to court for possession and sale until after the first anniversary so as to mitigate the effects of s 335A(2), it would still be sensible to begin the process of potential settlement for the

voluntary realisation of the asset which might highlight any issues that need to be dealt with or allow the trustee to comment adversely if the potential respondents have not raised any issues previously but do so in the proceedings.

CASE LAW

The Act gives no guidance as to what amounts to exceptional circumstances. For many years the leading authority of *Re Citro* [1991] Ch 142 gave guidance that the circumstances had to be outside of the usual melancholic consequences of debt and improvidence. In light of the passing of the Human Rights Act 1998, there was some doubt as to whether this authority could stand in the light of the rights to property and family life. In *Barca v Mears* [2004] EWHC 2170 (Ch) the court took the opportunity of re-interpreting *Re Citro* so that the usual melancholic consequences should not be taken into account unless they are so severe that they ought to be. This enabled s 335A to continue to be Human Rights Act compliant without the need to start a completely fresh set of case law.

Over the years there have been a number of cases relevant to the issue of what amounts to exceptional circumstances and, once that finding has been made, the application of the balancing act of the potential prejudice to the creditors if any sale is delayed as against the needs of others. There is little doubt that the person claiming exceptional circumstances has the burden of proof; in doing so it would seem must establish some reason as to why it is necessary to remain in this particular property for a period of time. In *Barca v Mears* itself, despite the court finding that the usual melancholic consequences of bankruptcy could be an exceptional circumstance, the stated desire to delay a sale for the bankrupt's son to complete his education was not in itself an exceptional circumstance. The creditors' rights would prevail. Of course, had the court decided that there were exceptional circumstances it would have been required to carry out the balancing exercise of s 335A(2) and could always conclude that the interests of the creditors would mean that the sale would proceed. It is not a given that a finding of exceptional circumstances means that any

realisation must be delayed, although that is usually the result.

Those cases in which exceptional circumstances have been found to exist often contain a strong element of medical circumstances. In *Re Bremner* [1999] BPIR 185 the bankrupt had a terminal illness with a life expectancy of six months and was being cared for by his wife. The court considered this did amount to exceptional circumstances and ordered the sale to be delayed until three months after the death of the bankrupt. The court also took into account that the creditors would be paid in full.

In possibly one of the severest of exceptional circumstances cases, *Re Haghighat* [2009] EWHC 90 (Ch), the bankrupt's eldest child had cerebral palsy with learning disabilities and epilepsy. A possession order was made but not to be enforced for a period of three years or three months from the date the child stopped residing at the property.

It can be seen that, even with a finding of exceptional circumstances, the court should not remove the trustee in bankruptcy's ability to get in and realise the asset but merely delay that realisation to allow for the exceptional circumstances and, perhaps, for a reasonable adjustment period.

For there to be a finding in favour of the respondent, the circumstances must be exceptional and there must be some reason as to why the sale of this particular property needs to be delayed. It should be shown how the needs cannot be met elsewhere. As an example, in *Donohoe v Ingram* [2006] EWHC 282 (Ch) the fact that the respondent wished to remain in the property for her child's education to be completed was not an exceptional circumstance. This was especially so when the time period suggested as some 12 years. The mere fact that there was sufficient equity to pay the creditors in full did not assist as that could not justify the delay in the creditors being paid.

In *Nicholls v Lan* [2006] EWHC 1255 the court considered the expert evidence on the mental state of the bankrupt's wife and concluded that there were exceptional circumstances. However, there was another property that she owned with her siblings and she could move into that property. For

this reason, when the court was carrying out the balancing exercise required by s 335A(2), it was not appropriate to delay the sale of the bankruptcy estate asset. This case is a real illustration that there must be some compelling reason for the respondent to remain in this property and the needs cannot be met elsewhere. Even if there is a compelling reason, the court is to consider the length of time in which the sale should be delayed.

The mere fact that the realisation of the property will be used entirely to pay bankruptcy costs and expenses is not in itself an exceptional circumstance as was held in *Harrington v Bennett* [2000] BPIR 630.

In more recent years the courts have examined again the ambit of exceptional circumstances. In *Ford v Alexander* [2012] EWHC 266 (Ch) both co-owners were subject to bankruptcy orders. That does not affect the fact that any application for possession and sale is subject to s 335A of the Act with the only distinction being that the two beneficial interests now vested in two separate estates. The claim made in this instance was the granting of a possession and sale order was a disproportionate step in comparison with the benefit to the creditors. The couple would lose their only home, they would not be accepted as homeless and they would not meet a priority need as they were childless and not vulnerable. There was some evidence of the couple suffering from medical conditions. They would have difficulty finding alternative accommodation due to their need to house their fish and terrapins, particularly a property in the area in which they currently lived. The judge noted that this argument was somewhat undermined by the fact that they had made no attempts to find an alternative property. The challenge was on the grounds that the interference with their Art 8 rights under the European Convention on Human Rights was being unjustifiably interfered with. If they were right, they should be permitted to continue to live in their property with the creditors not receiving anything until their deaths.

The bankrupts sought to argue that a test of proportionality should be inserted into s 335A(3). It should be construed as reading that the rights of creditors prevail 'unless the circumstances of the case were exceptional such

Feature

Biog box

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that it would be disproportionate to do so'. The High Court on appeal rejected any such notion as being consistent with the case law on human rights. In fact, the district judge had rejected the implication of proportionality but nevertheless considered the position as if it did apply. The decision was still reached that there was no reason to delay the sale. This would, of course, be consistent with the fact that, if the district judge had found that there were exceptional circumstances, it would have been necessary at that stage to carry out the balancing exercise. It could be said that proportionality is already built into s 335(A) at the appropriate stage (sub-s 2) and need not be inserted twice, ie at the consideration of exceptional circumstances for sub-s 3. The High Court considered that s 335A was already considered compliant with human rights law and there was no support for a further extension of the definition of what that entailed.

One interesting aspect of *Ford v Alexander* is that the bankruptcy order was made on 12 October 2007. The trustee was appointed on 26 April 2010. The three-year period under s 283A would have expired in October 2010. The trustee would, therefore, have had a short period of time in which to investigate the matter and reach a settlement. It is not recorded in the judgment what steps, if any, were taken by the Official Receiver prior to the appointment having been made but it would be regrettable if valuable time had been lost which rendered litigation more inevitable. There is no doubt that the earlier these issues can come to light, the more prospect there is of reaching a negotiated settlement without the recourse to court proceedings.

Pickard v Constable is a recent case to deal with exceptional circumstances. Whilst it says nothing new about the applicability of s 335A or the tests to be applied, it is a case which illustrates the practicalities of making such an assertion and what the court should require.

Mrs Constable was made bankrupt on 2 October 2014. An application for possession and sale was issued on 29 February 2016. Mr Constable asserted that he had a medical condition which affected his muscles causing him to be weak and tired and affected his breathing. His evidence said that his GP had stated that this was the worst case he had

seen in 25 years. The GP did not provide any evidence directly. The evidence to support Mr Constable came from his carer who said that she believed there was no way he would cope if he had to move, it would be devastating for them and neither of them could walk out of the front door let alone move things and set up a new home. The district judge ordered possession but suspended until the death of Mr Constable or when he permanently vacated the property. The trustees appealed.

The High Court judgment summarised the current law on exceptional circumstances as follows:

- A finding of exceptional circumstances is necessary to displace the presumption that creditors' rights prevail but their presence does not debar the court from making an order;
- Typically, exceptional circumstances in modern cases relate to the personal circumstances of one of the joint owners, such as a medical or mental condition;
- The categories are not to be defined or categorised but the court makes a value judgment looking at all the circumstances;
- The circumstances must be exceptional and outside the usual melancholic consequences of debt or improvidence or for there to be compelling reasons not found in ordinary cases;
- It is not uncommon for a wife with children to be evicted which will not produce enough for them to buy a comparable property in the same neighbourhood or, indeed, elsewhere. Whilst those circumstances evoke natural sympathy, they are not exceptional but are within the usual melancholic consequences;
- The creditors have an interest in the order for sale being made even if the net proceeds will go towards the expenses of the bankruptcy. The mere fact the proceeds will be swallowed up by the expenses is not an exceptional circumstance.
- The court was concerned with the balancing exercise to be carried out under sub-s 2. It considered that the interest of the creditors could not be delayed for longer than 12 months. For Mr Constable to succeed he would have needed far better evidence from medical experts

about his condition, better evidence on the non-availability of private sector accommodation, better evidence on his engagement with the local authority and better evidence of his and his wife's financial situation.

- The judgment of the district judge was criticised in that in that it could not have been made on the evidence but from the 'feel' of the case.

We can take from this case that an assertion of exceptional circumstances does not override the rules on evidence. In particular it should be remembered that a claim that one party is suffering from a medical condition and the consequences of that condition is a matter of expert opinion. For that evidence to have due weight attached to it, the court should be asked to give a direction for expert, opinion evidence to be adduced from a suitable expert appointed by agreement of the parties. Any purported expert evidence in the absence of a court direction to that effect must be susceptible to challenge.

It should also be remembered that a finding of exceptional circumstances merely engages the balancing test of sub-s 2 and the modern case law supports far more a sale being delayed for a reasonable adjustment period rather than the creditors rights being suspended indefinitely. The mere fact a case is exceptional is not a reason for the creditors to lose out altogether. ■

Further reading

- LexisPSL: Restructuring & Insolvency: Personal Insolvency; Dealing with the Family Home: Factors which can give rise to the court not making an order for possession and sale of the family home – and the test it will apply
- LexisPSL: Restructuring & Insolvency: Personal Insolvency; Dealing with the Family Home: Possession and sale applications in respect of a bankrupt's family home
- LexisPSL: Restructuring & Insolvency: Insolvency litigation; Bankruptcy and the matrimonial home: The 'three-year rule' in bankruptcy under section 283A of the Insolvency Act 1986