



## Introduction

Welcome to the Autumn 2010 edition of the Lavelle Coleman newsletter.

The announcement last June that Ireland has officially moved out of recession was welcomed news. However in recent weeks the expected rebound has again become uncertain.

The implosion of the country's economy has left most people with crippling debt and many are struggling to keep up the repayments of loans. Since the start of the recession there has been a sharp increase in the number of insolvencies, since January 2010 there have been 1,132 insolvencies to date.

Mirroring this trend in the market, Lavelle Coleman is being consulted more frequently across the spectrum of insolvency matters. In particular, over the last few months we have advised in many receiverships and liquidations, both voluntary and Court appointed. For this reason, this edition of the newsletter has a predominantly insolvency based theme.



Michael Lavelle Managing Partner

We have further strengthened our insolvency and corporate restructuring team with the appointment of Mark Homan as Partner. Mark has made a considerable contribution to Lavelle Coleman's insolvency and commercial litigation teams over the last eight years, with involvement in a number of significant transactions for local and international clients. Along with advising shareholder's, companies and company directors in commercial litigation disputes, Mark has acted for liquidators, receivers and examiners.

## Individual Voluntary Arrangements – The Future ?



Mark Homan  
Partner

**Ireland may technically have emerged out of the recession but for many people that is far from the reality. The demise of the Celtic Tiger has left many individuals with crippling debts leaving them struggling to keep up the repayments. This is further compounded by Irelands insolvency law and procedure which is complex, costly and in some situations archaic. For example under Irish insolvency law at present only Court supervised schemes of arrangements are permitted, there are no provisions for individual schemes of arrangements.**

However, change may be on the horizon. The Minister for Communications, Energy and Natural Resources, Eamon Ryan, recently announced that the government group set up to deal with personal debt is looking to introduce 'Individual Voluntary Arrangements' (IVA). IVAs are already well incorporated into the British personal insolvency regime and have proven very successful.

### British system of Individual Voluntary Arrangements:

Under the British system IVAs are legally binding arrangements supervised by an Insolvency Practitioner, the purpose of which is to enable a debtor to reach a compromise with his creditors. Any creditor on notice of the arrangement is precluded from taking any enforcement action against the debtor, provided the debtor complies with the arrangement.

The procedure for IVA is simpler than the Court supervised arrangements in Ireland. The proposals are drawn up by an insolvency practitioner, who then submits them to the Court, for the purpose of obtaining an interim protection order. This order prevents creditors taking any action against the debtor prior to the creditors meeting.

Following this a creditors meeting must be called. At the creditors meeting, the arrangement proposals must receive the backing of 75% in value of the creditors who vote at the meeting. Assuming the proposals are passed, a supervisor is appointed to ensure the proposals are implemented and to distribute the dividends to creditors. Provided that the debtor complies with the arrangement, then upon its completion he will be fully discharged from all liabilities.

The IVA procedure has proven to be extremely popular in the UK. In the first three months of this year alone there were 12,390 IVA's, this is up 20.9% on the same quarter from the previous year.

If the government does introduce Individual Voluntary Arrangements as a less restrictive and more informal alternative to existing bankruptcy laws then it highly probable that it will be similar to the British system of IVAs.

# Reversal of Fortune- Administration of Estates

**“Extraordinary”; this is how High Court Judge, Mr Peter Kelly in the Commercial Court, recently described the valuation of the estate of the founding director and shareholder of a large property developing/ construction company who appeared to be worth €100 million according to periodic statements of his personal net-worth sent to his bank prior to his death. According to the deceased’s Grant of Probate, his gross estate was worth c. €72,000 at the date of death.**

One unfortunate by-product of these extraordinary financial times is that more and more estates, previously worth millions based on sky high property prices and soaring share values in “blue chip” companies, have been dramatically reduced to a shadow of their former worth or resulting in an insolvent estate. In some cases it will be more than obvious that the estate is insolvent and the matter becomes instantly a posthumous bankruptcy process. However, it may not be always evident from the outset that an estate is insolvent. Property and certain quoted stocks values are very susceptible and vulnerable to change on an almost daily basis. “Hidden” debt such as unsecured personal loans, credit card debts and personal guarantees may all contribute to diminishing the value of an estate. However, they may not become apparent until well in to the process of preparing the papers for probate purposes or much later during the administration of the estate itself.

## Who administers the insolvent estate?

The personal representatives/executors named in the will may still extract the Grant of Probate or the next of kin in the case of intestacy. The Court may also appoint an official assignee to administer the estate. Alternatively, a creditor of the estate may apply for a limited grant to be extracted so that they can recover their debt to the extent that they are permitted. In all cases, the intended administrators are bound by the rules set out in the Succession Act 1965 (see further below) when distributing the estate.

## What rules apply?

The Succession Act 1965 sets out how insolvent estates are to be distributed. Schedule 1, Part 1 of the Act sets out the order in which distributions from the estate and payments are to be made. It can be summarised as follows:

1. The funeral, testamentary and administration expenses have first priority over all other debts and provisions made in the will of the deceased, if any.
2. Thereafter the rules of bankruptcy apply; the date of death being substituted for the date of adjudication in bankruptcy. This effectively means that where an estate is insolvent the administrator effectively becomes an official assignee and all of the deceased’s property will vest in him/her at the date of death of the deceased where the deceased died testate or at the date of the grant of letters of administration where the deceased died intestate.

## Matters to consider when dealing with an insolvent estate:

Several important matters and complex issues can arise in the context of these estates for all parties involved in the estate including administrators, creditors and beneficiaries.

After discharging the costs of 1) above, the administrator must then discharge the debts of preferential creditors such as Revenue debts and employee wages. Following that the administrator must distinguish between secured and unsecured creditors to establish their rank of priority. In order to protect themselves, the administrators should advertise in local and national newspapers for creditors to establish the existence of any creditor they have not previously been made aware of and then proceed to distribute the estate. When distributing the estate the administrator is not permitted to prefer one creditor over another.

Where assets fall outside of the estate e.g. joint accounts, nominations under insurance policies or credit union accounts these will not be taken into account in the distribution of the estate itself. A key matter to consider here is where the deceased has a nominated e.g. a spouse or child as the recipient of say a credit union account or life assurance policy within two years of his bankruptcy ie death. These will be treated as void transactions if it can be shown that the deceased was unable to pay his or her debts at they fell due without recourse to that asset.

A creditor of an insolvent estate may find that there is no incentive for the persons nominated as executors under a will or the next of kin to extract a grant of probate. In such circumstances, the creditor is entitled to apply for a grant limited to securing repayment of their debt to the extent they are entitled to.

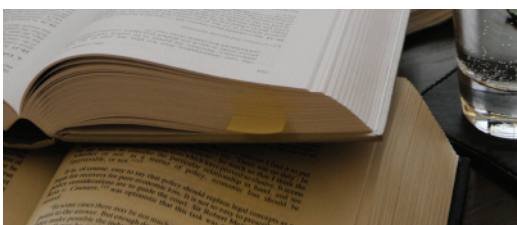
The beneficiaries may find that generous provisions made for them under a will are completely eliminated as a result of the estate being insolvent. This can lead to very harsh results for families. It is imperative in the current climate that careful estate planning takes place in order to avoid situations where families are left in financial uncertainty. Where an estate is not insolvent, but values have fallen significantly since the date of death, careful planning is also required to maximise inheritance tax exemptions for beneficiaries.

## Claims against the Estate

Persons with a legitimate claim against an estate should note that there is a limited time period in which they may bring claims against the estate of a deceased person where a cause of action exists at the date of death of the deceased. Claimants in certain circumstances may only have up to 2 years from the date of death to bring an action against a deceased’s estate depending on the type of claim in question and when the cause of action arose. Advice should always be taken to ensure that the relevant steps can be taken to protect the interests of those involved.



Anne Smith  
Solicitor





## Negative Equity and Mortgage Default

**It is an unfortunate sign of the times that Mortgage Litigation has become an increasing feature in the Court system. The number of proceedings being issued has reached unprecedented levels with the number of Orders of Possession per annum trebling since 2007.**

Residential property investors are a major feature in Ireland and have become increasingly so over the past decade with their share of the market increasing from 2% in 1997 compared with 28% at the peak of the property boom in 2007. These investors have played a significant role as borrowers from the banking system. According to the ESRI House Price Index, the housing market peaked in early 2007, having experienced a boom since the mid 1990s. Consequently residential mortgage debt has increased from €14bn in December 1996 to nearly €148bn in December 2008\*.

The steady decline in house prices since 2007 has created an increasing problem with negative equity.\*\* Mortgage lenders are now looking at alternative options available under the mortgage deed other than the traditional repossession route, in order to protect their interest in the event of default by borrowers. The most obvious yet surprisingly under used power for “buy to let” properties is the power to appoint a Receiver over the rents in properties where the borrower has defaulted and there is a tenant in place. The process is designed to secure the payments being received by the borrower in respect of rent, by allowing the lender to intercept the rental income and assign the payments directly to the mortgage account in payment of the capital and interest on the loan. Appointing a Receiver is an efficient method of securing repayments, where the Receiver is deemed an agent of the borrower and therefore the lender has no liabilities in respect of the management or maintenance of the mortgaged property. The Receiver is appointed by way of a Deed and notice is given to the tenants that all future rents are to be paid to the Receiver.

Issuing Court proceedings is often unavoidable in cases involving a principal private residence, where the borrower refuses to engage. Owner occupied homes are being impacted by negative equity and furthermore increasing levels of mortgage default. Often if a borrower is experiencing cash flow difficulties, the presence of negative equity may reduce the willingness of the borrower to make repayments. The borrower may deem default a more satisfactory outcome than continuing to struggle to make repayments for a property that is in significant negative equity. However it seems that negative equity alone does not cause a borrower to default rather it is a feature of default.

Negative equity has had a two fold impact on mortgage lenders. It has impacted the value of the mortgaged based assets held by the bank and it appears it can increase the probability of default by a borrower. If a long term perspective cannot be adopted by the lender, the most

valuable power under the mortgage deed is the power to apply to the Court for an Order of Possession. Obtaining an Order of Possession allows the lender, if no agreement can be reached with the borrower, to take possession of the property and subsequently put the property on the market for sale. The Land and Conveyancing Law Reform Act 2009 amended the law in this area. Proceedings for Orders of Possession, for mortgages created after the commencement of the Act, must now be brought in the Circuit Court.



Gráinne Dever  
Solicitor

In an effort to reduce the level of default, the Government and mortgage lenders have reacted to the problem of negative equity and increased mortgage default.

The Mortgage Interest Supplement Scheme is available to owner occupiers who are in difficulty. The reliance on the scheme has increased by 75% since the end of 2008.

The Financial Regulator’s Code of Conduct on Mortgage Arrears (“the Code”) issued in February 2009. The Code states that mortgage lenders must engage with the borrower and consider all options available before issuing Court proceedings. Proceeding to Court is deemed to be a last resort where the borrower is refusing to engage with the lender or has abandoned the property. The Code ensures that borrowers are given every opportunity before losing their homes but it must be noted that the Code does not relieve the borrower of his/her contractual obligations under the terms of the mortgage without the agreement of the lender.

Since June 2009, the IBF-MABS Protocol sets out a detailed approach to debt problems for personal debtors and an agreement to adopt certain principles in addressing the matter which include inter alia, priority of secured over unsecured debt, entering into arrangements to pay on alternative terms and monitoring repayment plans.

\* Central Bank Data

\*\*\*“Negative Equity – if a house price falls below the value of the outstanding debt”



## First Step Towards Change

**In contrast to many other countries such as the UK and USA where bankruptcy legislation has been modernised to enable people with overwhelming debts to obtain access to the protection of the Courts relatively easily, Ireland's bankruptcy legislation is arguably out of date and in much need of modernisation.**

An individual who has been declared a bankrupt is still viewed with a degree of suspicion and is almost perceived to have acted recklessly. Given how bankrupts have traditionally been viewed, it is not surprising that our bankruptcy laws are so penal. However in recent times there have been signs of change in the attitude towards bankruptcy.

The Civil Law (Miscellaneous Provisions) Bill 2010 proposes two significant changes to bankruptcy in Ireland. The major change will enable a bankrupt to apply to be discharged after six years rather than twelve as it currently stands. The second significant change is that the bill also proposes an automatic discharge of bankruptcies after twenty years. Despite the proposed changes, the same criteria will apply for this new period as currently does for the twelve year period. For a bankrupt to be discharged they must be able to pay the expenses of the Official Assignee, the costs of the petitioning creditor, any other preferential payments owed, and the assets of the bankrupt must also be totally realised.

While these new proposals are to be welcomed, the major problems with our bankruptcy laws remain. Current legislation doesn't favour creditors as the assets become part of the bankrupt's Estate and the realisation of the assets can be cumbersome involving court applications, delays and additional costs. A reform of our bankruptcy laws that incorporate a mechanism for voluntary schemes of arrangement outside the Court system is essential for both creditors and individuals.

In the UK most bankrupts are discharged within twelve months, while in the US the period of discharge varies from four months to four years depending on the kind of bankruptcy filed for.

The current bankruptcy laws are out of date and anti-entrepreneurial. The new proposed provisions must be viewed as a first step towards change and not an end in themselves. What is ultimately needed is a complete overhaul of the bankruptcy legislation, to create a system in which the bankruptcy procedure is simplified and the costs involved are significantly reduced.



Michael Lavelle  
Managing Partner

