

INSOLVENCY IMPLICATIONS FOR MORTGAGOR

Impact on Secured Creditors

A secured creditor is generally entitled to enforce its security irrespective of the insolvency or bankruptcy of the mortgagor. The mortgage is entirely independent of the individual's bankruptcy or a company's winding up proceedings. There are however, practical consequences for the mortgagee in event of the insolvency of the mortgagor.

Once a bankruptcy petition (a request by a creditor or the debtor himself to court for a bankruptcy order) is pending, the court can stop or "stay" any legal claim or enforcement of an existing court order, against the person or property of the debtor. The courts may suspend proceedings or allow them only to continue on such terms as they specify.

Legal proceedings are suspended because bankruptcy aims to treat all unsecured creditors equally. The purpose of the bankruptcy process is to ascertain all of the bankrupt debtor's assets and divide them between his creditors. Preferential creditors and secured creditors have greater rights than other creditors.

A mortgagee is entitled to enforce its security, irrespective of bankruptcy. If the security is not sufficient to cover the debt, then it is treated as an unsecured creditor in respect of the balance. A secured creditor could surrender his security and prove for his entire debt as an unsecured creditor.

A secured creditor who does not choose to surrender his security, can use his ordinary rights to enforce its security. This is an exception to the general rule whereby enforcement cannot be undertaken against any bankrupt. However a mortgagee cannot at the same time retain his security and claim for the whole balance of his in the bankruptcy proceedings.

Enforcement of Security

At any time after insolvency proceedings are commenced certain parties (depending on whether a company insolvency or individual bankruptcy is involved) may apply to court where proceedings are pending against the debtor, in order to have them restrained.

A court will be very unwilling to interfere with the rights of a secured creditor. It would be necessary to persuade a court there was some special grounds for refusing permission to proceed to enforce the security. Even if enforcement is restrained temporarily or otherwise, this does not take away the secured creditors rights to its security and the proceeds of its sale. The mortgagee's has property rights which cannot be taken away.

After an individual has been made bankrupt, it is not generally possible to take a legal claim against the debtor, without court consent. The claimant must claim for the debt in the bankruptcy proceedings. The holder of a charging order arising on the enforcement of a court order or judgment is not a secured creditor.

If a court order is being enforced or "executed", then a creditor may only retain proceeds of a completed "execution". In the case of goods, execution is finalised after seizure of goods and sale by the sheriff.

Administration

Administration is the United Kingdom equivalent of examinership. It is only available for companies. An administrator can be appointed by court or by the holder of a floating charge. The appointment lasts one year, which may be extended.

The administrator must set out a proposal in relation to the objectives of the administration of the company. The objective will usually be either to try to achieve the survival and rehabilitation of the company as a going concern or to secure a more advantageous realisation of the company's assets than would apply in a winding up.

Administration has a greater impact on secured creditors than other insolvency processes such as liquidation. In an administration, no steps can be taken to enforce

security except with the consent of the administrator or with permission of the court. Similarly, no legal proceedings which have started can continue without the consent of the administrator or court

The court may give permission to secured creditors to enforce their security. The purpose of the requirement for court consent is to assist the company in managing the administration in order to achieve the designated purpose of the administration. However, the administration procedure should not be used to prejudice secured creditors.

It would normally be a sufficient ground to grant permission to a secured creditor to enforce, that a significant loss or cost would be incurred by the secured creditor by refusing permission or if delaying enforcement is likely to be prejudicial or where the security is insufficient. Permission may be refused where the purpose of the administration order would be frustrated by granting permission.

A secured creditor should make his position clear to the administrator quickly and apply to court promptly. In one case, permission was refused where the secured creditor had stood by and taken advantage of administrator's operations over some months. A court will not deal with issues in relation to validity or enforceability of the security in these applications. The court need only be satisfied that the security appears to be in order.

A Court may make an order to enable an administrator to dispose of property, which is subject to security (other than a floating charge) as if it was not subject to the security. This order will only be made on the application of the administrator, where the court thinks the disposal of the property would be more likely to promote the objective of the administration. Such an order must be subject to the condition that the sum realised by the security will be applied by discharging sums due to the security holder. There are similar provisions in relation to floating charges.

Dealings with the Bankruptcy Trustee or Liquidator

A secured creditor who does not choose to come under bankruptcy rules is entitled to pursue his security. He cannot retain his security beyond the full value of the debt. A

secured creditor is only entitled to vote in insolvency proceedings in respect of the balance, after deducting the value of the security.

The Official Receiver or trustee in bankruptcy supplies forms for proving the debt. The debt must be proved by affidavit. If a secured creditor omits to disclose the security in proving the debt, he may lose the benefit of it, unless the court accepts that the omission was inadvertent and as a result of an honest mistake.

The Official Receiver / trustee in bankruptcy is entitled to give notice to a creditor whose debt is secured that he proposes after 28 days to redeem the security at the value he puts on it. The security holder has 21 days or such longer period as the trustee allows us to exercise a right to revalue the security. If this is done, the trustee may redeem at this value. The secured creditor may by notice in writing call on the trustee to elect whether he will exercise the power to redeem the security at the value placed on it. The OR/ trustee has six months in which to decide whether or not to exercise the power.

This Guide is intended as an overview and broad outline of the matters covered in it. Its purpose is to inform and raise awareness. We are happy to offer specific legal advice on particular circumstances.

This Guide should not be relied on as a substitute for comprehensive legal advice with reference to the particular circumstances.

While we have taken due care in the preparation of this publication, we do not accept legal liability as a result of any reliance placed on anything in this Guide. The reader should rely only on specific legal or taxation advice.