

## 39. Implications of Insolvency for Mortgagee

### General

If the borrower's centre of main interests is in Ireland, then Irish insolvency law will apply. The Irish insolvency system has not been modernised in the same way as other systems such as the UK systems and is perceived to be expensive and inflexible. The recent Law Reform Commission Report has recommended considerable changes.

Irish insolvency rules protect the secured lender's property rights to its security. These rights are not prejudiced or reduced by the insolvency. The secured asset is not included in the assets available for distribution to the borrower's unsecured creditors.

The basic rule is that a secured creditor cannot claim against the insolvent person's or company's assets and claim its security at the same time. The secured creditor may do the following:

- ❖ retain its security and rely on it only;
- ❖ release its security and claim in bankruptcy for the entire debt;
- ❖ realise or value the security and prove for the balance.

It may be that the security is sufficient. If the security yields a surplus, then the surplus must be paid to the bankruptcy trustee or liquidator. If the security is insufficient, then the lender will need to consider what course of action is to its best advantage.

A liquidator or bankruptcy trustee calls for proof of debt from the various creditors as part of the insolvency process. The secured creditor must state if it is secured. If the security is not stated, it must be surrendered to the assignee, trustee or liquidator for the benefit of the creditors, unless the courts allows an amendment and excuses the omission.

A judgment mortgagee is not a secured creditor and has no priority, unless his judgment mortgage is registered for at least three months prior to bankruptcy.

### Valuing Security and Insolvency Officer's Options

There are special rules in relation to valuing the security. It is not generally possible to amend a valuation. If the value subsequently realised is different, the secured creditor is required to adjust his claim. The Official Assignee or liquidator may redeem the security at the value declared. This gives the secured lender an incentive not to

undervalue. The secured creditor may give notice and require the Official Assignee or a liquidator to decide whether to redeem or offer the security for sale. The Official Assignee or liquidator has three months within which to decide whether he will exercise these options.

Even if the Official Assignee or liquidator exercises the above options, he must still account to the secured creditor for its rights to the proceeds of sale of the secured asset.

## **Set aside of pre-insolvency transactions**

Certain transfers of assets made in a period before bankruptcy can be unwound and invalidated, by court order made on application by the bankruptcy trustee or Official Assignee. See our chapter in relation to invalidity and impairment of security. This is a particular risk in entering an arrangement with a debtor in financial difficulties, which involves the grant of additional security. The security may be set aside if the borrower later becomes bankrupt. In addition, the borrower's ability to perform any agreement will be negated by a later bankruptcy. There are equivalent rules for company liquidations.

A preference given to a creditor, with the intent of putting him in a better position in

insolvency than he would otherwise have been in, may be set aside. If the preference is given within six months before commencement of insolvency, it can be deemed void. Longer periods may apply, if the benefited person is connected.

Transfers made, with the intention of defeating delaying or hindering creditors or preventing the proportionate distribution of assets, may be set aside by court. The transfer must be proved to be a ~~fraudulent~~ conveyance+ (i.e. deliberately done for this reason). There is no time limit in which such a transaction may be set aside. If an asset is transferred for no value or very unequal value in return (effectively a gift), it is easier to show the intention to avoid creditors.

There are bankruptcy rules which invalidate gifts and transfers at undervalue made within a certain time of bankruptcy. A transfer made within two or five years before bankruptcy other than in good faith and for valuable considerations can be avoided if the transferor was insolvent at that time. Consideration does not have to be equal in order to be valuable but it must be substantial and reasonable. A mortgage without a new loan advance can fall into this category. The two year period applies to most commercial arrangements. The longer five year period applies to arrangements with connected persons.

The onus is on the Official Assignee in bankruptcy to prove the debtor's insolvency at the time. %Solvency+ means that debtor was able to pay his debts without the aid of the property transferred. Regardless of the debtor's financial circumstances, a transfer of assets at undervalue made within two years of bankruptcy can generally be set aside, except when certain limited exceptions apply. The insolvency of the debtor does not have to be shown.

## **Examinership**

A secured creditor may not take any action to realise its security without the examiner's consent. The examiner can apply to court for permission to sell property which is mortgaged. The examiner must show the sale would facilitate the survival of the company as a going concern.

The court may order that a secured property be sold, as if it was not subject to the mortgage. The mortgagee is entitled to the proceeds of sale or the market value of the property (or at least as much as may be necessary to cover the debt). If the property is not sold for full market value, any deficiency must be made up from the remaining company assets. If there are several securities, the proceeds of sale must be applied in accordance with the order of

priority.

An examiner may apply to the court to dispose of assets which are comprised in a floating charge. The court may allow the disposal where it is likely to facilitate the survival of the whole or part of the company as a going concern. The charge holder has the same priority in respect of the proceeds, as it had in the assets disposed of. It is subject to the claims of preferential creditors, as would be the case under a floating charge.

The examiner may incur expenses on behalf of the company during the examinership period. This could include trading liabilities and payments to employees. An examiner's fees and expenses which are certified, obtain priority over all other claims against the company except fixed charge/mortgage security holders. This includes other secured and unsecured claims.

*This is an extract from our "Legal Guide to the Management and Enforcement of Security in Ireland" (2009). The 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. It 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 it. The reader should rely only on specific legal or taxation advice. This extract is based on the law as of 1<sup>st</sup> October 2009.*

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## CONTACTS

Paul McMahon [pmcmahon@lavellecoleman.ie](mailto:pmcmahon@lavellecoleman.ie)

Phone: (353) 1 6445800

Fax: (353) 1 6614581

Lavelle Coleman  
Solicitors  
20 On Hatch  
Lower Hatch Street  
Dublin 2  
Ireland

[www.lavellecoleman.ie](http://www.lavellecoleman.ie)