

Keeping your eye on the ball – insolvent estates

In this present time, the probability of encountering an insolvent estate after a death will no doubt be greater. An estate is insolvent if the assets are insufficient to pay all the debts and liabilities, including any expenses. If you are a personal representative (PR) of an insolvent estate, there are certain steps you must take to ensure you are not personally liable.

A PR would normally be the executor named under a will or the administrator, usually next of kin, if someone dies intestate (ie without a will) and has primary responsibility for administering the estate. Prior to taking on this role, the PR must consider carefully if there is any likelihood of the estate being insolvent, due to the potential personal risk involved. The consequences of not checking the status of the estate, are potentially huge and could mean the PR is personally liable to pay creditors out of his/her own pocket.

An insolvent estate may be administered in one of three ways:

1. By the PR – this is the most usual.
2. By the PR under the court's direction pursuant to an administration order.
3. Pursuant to an insolvency administration order (IAO) made by the bankruptcy court (estate vests in trustee in bankruptcy appointed by the Official Receiver).

The main practical implications of an insolvent estate are that beneficiaries under will/intestacy will receive nothing, and only some of the creditors will be paid in full. However, the key issue is the order in which the debts are to be paid.

Steps to take when dealing with an insolvent estate

Reasonable expenses have priority over all other unsecured liabilities. Secured creditors can normally rely on their security. Beneficial interest in joint property passing by survivorship can be brought into account.

There is a priority order for unsecured creditors:

(1) preferential debts (eg pension scheme contributions, remuneration of employees); (2) ordinary debts; (3) interest on preferential and ordinary debts; and (4) deferred debts. If the PR fails to observe priority order, he risks personal liability:

- in absence of notice, if, for example, he pays an ordinary debt before a preferential debt has been paid in full
- to other creditors in the same class if one debt paid in full when insufficient funds available to pay all debts in that class in full (unless the debt paid in full, in good faith, when the PR had no reason to believe the estate is insolvent).

There are considerable risks for a PR in administering an insolvent estate, but as long as due care is taken, a PR should not be put off from proceeding as his reasonable expenses will be met out of the estate.

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Key points to consider

- Payments made and expenses incurred in good faith prior to knowledge of an insolvency should not be set aside.
- If any doubt regarding an estate's insolvency, it should be administered as if it were insolvent.
- Liaise with creditors and come to an agreement with them.
- If in any doubt make applications to the court.