



# PUMP COURT

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## CHAMBERS

Dealing with Insolvent estates

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- An estate is insolvent when its assets are insufficient to discharge all liabilities in full. Such estates must be administered for the benefit of creditors, not beneficiaries.
  - There is an enormous risk to personal representatives (**PRs**): executors and administrators can incur personal liability if they distribute assets out of the required order or without regard to insolvency principles.
  - The purpose of this seminar is to familiarise practitioners with the regime as issues of insolvency can arise before and during the administration of the estate.
  - The key legislative framework includes:
  - ***Insolvency Act 1986 (IA 1986)*** – especially section 421(4) (definition of an insolvent estate) and related provisions;
  - ***Administration of Insolvent Estates of Deceased Persons Order 1986 (SI 1986/1999)*** (“**DPO 1986**”) – which applies the bankruptcy regime, with modifications, to the estates of deceased debtors.
  - The Law Society has prepared a practice note for Administering Insolvent Estates (2023) and this seminar has been prepared with that note in mind, as well as other sources and guidance such as Williams, Mortimer & Sunnucks.
  - All guidance emphasises strict compliance with the statutory hierarchy of payments and careful documentation of every step and it is hoped that this paper will provide a useful introduction and springboard into this important topic.

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## Section 421(4) IA 1986 – Definition of Insolvent Estate

S 421(4)

*For the purposes of this Part, the estate of a deceased person is insolvent if, when realised, it will be insufficient to meet in full all the debts and other liabilities to which it is subject.*

[www.legislation.gov.uk/ukpga/1986/45/section/421](http://www.legislation.gov.uk/ukpga/1986/45/section/421)

## Commentary

- This short but crucial subsection defines insolvency for all purposes of this regime.
- It is forward-looking: the PR must consider whether, when realised, the estate will be insufficient. It embraces every liability—present, contingent, or future. No formal court declaration is necessary: if there is real doubt, the PR must assume insolvency and follow the statutory order to avoid devastavit (wasting of assets).
- Section 421(4) **IA 1986** ensures conceptual harmony between probate administration and bankruptcy law.

# The Administration of Insolvent Estates of Deceased Persons: Order 1986

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*Article 3 – Application of Bankruptcy Provisions: (1) The provisions of the IA 1986 and the Insolvency Rules 2016 (**IR 1986**) which are applicable to the bankruptcy of individuals shall apply (with such modifications as are specified in Schedules 1 to 3) to the administration in bankruptcy of the insolvent estate of a deceased person. (2) Those Schedules shall have effect for making such modifications and adaptations as appear necessary for the application of the said Act and Rules to such cases.*

[www.legislation.gov.uk/uksi/1986/1999/article/3](http://www.legislation.gov.uk/uksi/1986/1999/article/3)

*Article 4 – Administration Otherwise Than in Bankruptcy: (1) Where the estate of a deceased person is insolvent and is being administered otherwise than in bankruptcy, the same provisions as may be in force for the time being under the law of bankruptcy with respect to the assets of individuals made bankrupt shall apply to the administration of the estate with respect to the respective rights of secured and unsecured creditors, to debts and liabilities provable, to the valuation of future and contingent liabilities and to the priorities of debts and other payments. (2) Nothing in this article shall alter the order in which funeral, testamentary and administration expenses are to be paid.*

[www.legislation.gov.uk/uksi/1986/1999/article/4](http://www.legislation.gov.uk/uksi/1986/1999/article/4)



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*Schedule 1 paragraph 20 – Expenses and Funeral Costs: 'All reasonable funeral, testamentary and administration expenses incurred by the personal representative of a deceased debtor in administering the estate shall be payable in priority to all other payments.'*

<https://www.legislation.gov.uk/uksi/1986/1999/schedule/1>

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## Commentary

The **DPO 1986** is the statutory bridge between probate and insolvency. Article 3 applies the full bankruptcy framework to estates placed under a formal Insolvency Administration Order (***IAO***). Article 4 extends those bankruptcy principles to out-of-court administrations by PRs. Consequently, the ranking of debts, the treatment of contingent liabilities, and the rights of secured creditors mirror personal-bankruptcy law. Schedule 1 para 20 preserves one specific probate principle: reasonable funeral and administration expenses have absolute priority.

# The Three Routes for Administration

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- Therefore, three routes exist under the **DPO 1986** for administering an insolvent estate:
- (a) Out-of-Court Administration by PR,
- (b) Administration under Court Direction (CPR Part 64 which is the part of the CPR which deals with questions arising in the administration of an estate or trust), and
- (c) Administration in Bankruptcy via Insolvency Administration Order (**IAO**).

- The default (normal) route where PRs act without a formal insolvency practitioner. PRs must apply bankruptcy principles and prepare a statement of affairs. This method is less costly but carries personal risk for errors. Although these can be mitigated by *ad hoc* applications under CPR Part 64 (and or for a *Beddoe (GL)* order).

# Beddoe Application (a reminder)

*An application made to the court under Part 64 of the Civil Procedure Rules for directions whether or not the trustee should bring or defend, or continue to bring or defend, proceedings in his capacity as trustee. An order made in a Beddoe application authorises the trustee to do so and to be indemnified out of the trust fund in respect of the costs incurred in the proceedings to which the application relates, including any costs which he might be ordered to pay to another party to the proceedings. Such an order operates to indemnify and protect the trustee as between himself and the beneficiaries, to the extent (subject to the effect of a subsequent unforeseen adverse developments) of the steps which are authorised to be taken, and to remove doubts which otherwise exist as to whether he is entitled to indemnity. The protection is effective, however, only if the trustee has made full and proper disclosure to the court in the Beddoe application.*

Lewin on Trusts 20<sup>th</sup> Edn ¶48.130

- This indemnity is therefore stronger than the indemnity under CPR r46.3 and provides greater certainty before proceeding in a particular manner

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***Limitations on court's power to award costs in favour of trustee or personal representative***

**46.3**

*(1) This rule applies where –*

*(a) a person is or has been a party to any proceedings in the capacity of trustee or personal representative; and*

*(b) rule 44.5 does not apply.*

*(2) The general rule is that that person is entitled to be paid the costs of those proceedings, insofar as they are not recovered from or paid by any other person, out of the relevant trust fund or estate.*

*(3) Where that person is entitled to be paid any of those costs out of the fund or estate, those costs will be assessed on the indemnity basis.*

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*Awards of costs in favour of a trustee or personal representative: rule 46.3*

*1.1 A trustee or personal representative is entitled to an indemnity out of the relevant trust fund or estate for costs properly incurred. Whether costs were properly incurred depends on all the circumstances of the case including whether the trustee or personal representative ('the trustee') –*

- (a) obtained directions from the court before bringing or defending the proceedings;*
- (b) acted in the interests of the fund or estate or in substance for a benefit other than that of the estate, including the trustee's own; and*
- (c) acted in some way unreasonably in bringing or defending, or in the conduct of, the proceedings.*

*1.2 The trustee is not to be taken to have acted for a benefit other than that of the fund by reason only that the trustee has defended a claim in which relief is sought against the trustee personally.*

# Administration under Court Direction

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- Where solvency is uncertain or disputes arise, a PR or creditor may apply under CPR Part 64. The court supervises administration, providing binding directions and limited protection. It should be noted, however, that administrations under CPR Part 64 are likely to be rare (see para 3.1 of CPR PD 64A). Moreover, a petition for an insolvency administration order cannot be presented after proceedings have been commenced under CPR Part 64.
- However, note limitations/ provisions under para 3 of CPR PD64A



*Administration orders – rule 64.2(b)*

**3.1** *The court will only make an administration order if it considers that the issues between the parties cannot properly be resolved in any other way.*

**3.2** *If, in a claim for an administration order, the claimant alleges that the trustees have not provided proper accounts, the court may –*

*(1) stay the proceedings for a specified period, and order them to file and serve proper accounts within that period; or*

*(2) if necessary to prevent proceedings by other creditors or persons claiming to be entitled to the estate or fund, make an administration order and include in it an order that no such proceedings are to be taken without the court’s permission.*

**3.3** *Where an administration order has been made in relation to the estate of a deceased person, and a claim is made against the estate by any person who is not a party to the proceedings –*

*(1) no party other than the executors or administrators of the estate may take part in any proceedings relating to the claim without the permission of the court; and*

*(2) the court may direct or permit any other party to take part in the proceedings, on such terms as to costs or otherwise as it thinks fit.*

**3.4** *Where an order is made for the sale of any property vested in trustees, those persons shall have the conduct of the sale unless the court directs otherwise.*

# Administration under Court Direction

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- NB The PR must ensure that a power to charge for their services is included within the administration order if they are entitled to be paid for administering the estate
- NBB Although a petition for an **IAO** cannot be presented after CPR 64 proceedings have commenced (section 271(2), **IA 1986** as amended by paragraph 5, Schedule 1, **DPO 1986**), the court hearing the administration order application may, if satisfied that the estate is insolvent, transfer the proceedings to a court with insolvency jurisdiction. That insolvency court may subsequently make an IAO as if a petition for an **IAO** had been presented by a creditor (section 271(3), **IA 1986**, as amended by paragraph 5, Schedule 1, **DPO 1986**).

# Administration in Bankruptcy – Insolvency Administration Order

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- Administration of the deceased debtor's estate is generally subject to the same regulation as a living bankrupt's estate, save for the priority given to the reasonable funeral, testamentary and administration expenses
- Any creditor, PR, or IVA supervisor may petition for an **IAO**. Once made, the trustee in bankruptcy assumes control, and the PR's duties cease. This route offers strong protection but higher costs.
- This route is also the situation where a person who is the subject of a bankruptcy petition that has been filed dies (Article 5(1) of **DPO 1986**). If service not effected before death, then the Court can make an order for substituted service on the deceased debtor's PR (Article 5(3) of DPO 1986).
- In the context of an application for directions under Part 64 of the CPR, the High Court acknowledged that article 4(1) of the **DPO 1986** does not provide a mechanism for satisfying all of the deceased's established liabilities
- See **Berry v Child Support Agency and others [2016] EWHC 1418 (Ch)**).

# Administration in Bankruptcy – Insolvency Administration Order cont'd

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- Unless the court orders otherwise, the trustee will remit surplus funds (if any remain after payment of creditors) to the PR for onward distribution to beneficiaries as the trustee does not distribute to beneficiaries directly (section 330(5), IA 1986 as amended by paragraph 25, Schedule 1, **DPO 1986**).

- Section 382 **IA 1986** – Meaning of “Debt” and “Liability”: (1) 'Debt' includes any debt or liability existing at or arising from obligations before the bankruptcy order. (2) 'Liability' means a liability to pay money or money's worth, including any under an enactment, trust, or tort, whether present, future, certain, or contingent. Any reference to owing a debt is to be read accordingly.

[www.legislation.gov.uk/ukpga/1986/45/section/382](http://www.legislation.gov.uk/ukpga/1986/45/section/382)

## Commentary

- Section 382 IA 1986 confirms that all contingent, future, and uncertain liabilities are to be considered. For PRs, this means potential or disputed debts must be treated as part of the estate's liabilities when assessing solvency.
- For insolvent estates in bankruptcy, see section 267 of the **IA 1986** and section 5 of the **DPO 1986**)

# Defining Insolvency cont'd

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- *Whether a deceased's estate is insolvent is a question of fact (Re Pink [1927] 1 Ch 23; Re Savile (deceased) [2014] EWCA Civ 1632).*
- *There is no need for a court order declaring an estate to be insolvent. If the estate is, or may become, insolvent, it should be administered for the benefit of the estate creditors and not the beneficiaries under the terms of the deceased's will or intestacy rules. If the PR is in any doubt about the estate's solvency, and regardless of which method of administration is used, they should assume that it is insolvent and follow the statutory order for the priority of payment of debts (see Order of payment of estate debts and liabilities).*
- *This is confirmed in Obligation 30.2 of the Law Society Wills and Inheritance Quality Scheme Protocol.*

# Duty of Personal Representatives (PRs) and the Statutory Regime for Protection

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- Personal Representatives (executors or administrators) owe fiduciary duties to creditors before beneficiaries. They are personally liable for devastavit if they misapply assets or fail to follow the statutory order.
- Statutory protection comes from s10 of the Administration of Estates Act 1925 1971 and s61 of the Trustees Act
- There is a further relevant provision (subject to the insolvency provisions) for compromise under s15 of the Trustee Act 1925

# Statutory protection (s10 of the Administration of Justice Act 1985 1971)

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Section 10(2) **Administration of Estates Act 1971** – Protection for PRs: where acting in good faith and unaware of insolvency, payments made to same-class creditors are valid.

*10 Retainer, preference and the payment of debts by personal representatives.*

*(1)....*

*(2)Nevertheless a personal representative—*

*(a) other than one mentioned in paragraph (b) below, who, in good faith and at a time when he has no reason to believe that the deceased's estate is insolvent, pays the debt of any person (including himself) who is a creditor of the estate; or*

*(b) to whom letters of administration had been granted solely by reason of his being a creditor and who, in good faith and at such a time pays the debt of another person who is a creditor of the estate;*

*shall not, if it subsequently appears that the estate is insolvent, be liable to account to a creditor of the same degree as the paid creditor for the sum so paid.*

[www.legislation.gov.uk/ukpga/1971/25/section/10](http://www.legislation.gov.uk/ukpga/1971/25/section/10)

Note: The best protection for a PR in circumstances where the estate is complex and clearly insolvent is to obtain an **IAO** before distributing the deceased's estate



Section 61 **Trustee Act 1925** – Court may relieve trustees (including PRs) from personal liability if they acted honestly and reasonably

*61 Power to relieve trustee from personal liability.*

*If it appears to the court that a trustee, whether appointed by the court or otherwise, is or may be personally liable for any breach of trust, whether the transaction alleged to be a breach of trust occurred before or after the commencement of this Act, but has acted honestly and reasonably, and ought fairly to be excused for the breach of trust and for omitting to obtain the directions of the court in the matter in which he committed such breach, then the court may relieve him either wholly or partly from personal liability for the same.*

[www.legislation.gov.uk/ukpga/Geo5/15-16/19/section/61](http://www.legislation.gov.uk/ukpga/Geo5/15-16/19/section/61)

To avoid or mitigate a PR's liability for a devastavit, loss to the estate may be recouped by bringing:

- A personal claim in restitution against those who have received a share, or all, of the estate, seeking a refund of amounts paid under the principles of unjust enrichment.
- A proprietary claim seeking recovery of the assets that have been wrongly distributed or other assets representing those assets.
- Before embarking on litigation, it may be sensible to consider a Beddoe application (see above). This of course only provides cost protection.
- Section 15 of the Trustee Act 1925 provides quite wide powers to compromise.

[www.legislation.gov.uk/ukpga/Geo5/15-16/19/section/15](http://www.legislation.gov.uk/ukpga/Geo5/15-16/19/section/15)

- If in doubt, seek advice.

# Payment of Debts – the Waterfall of Distribution

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- The order of payment in an insolvent estate follows the statutory hierarchy mirroring bankruptcy under Part IV of the IA 1986.
- PRs must follow this sequence strictly to avoid personal liability.
- Section 328 deals with priority of debts.
- Section 329 – Debts to spouse
- Section 330 – Final Distribution

# The Waterfall of Distribution cont'd

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## Commentary

Sections 328–330 **IA 1986** create the statutory “waterfall of distribution”:

- (1) Secured creditors;
- (2) Expenses of bankruptcy;
- (3) Preferential debts;
- (4) Ordinary unsecured debts;
- (5) Interest;
- (6) Deferred debts;
- (7) Surplus to PR for beneficiaries.

Under the DPO 1986, these rules apply equally to deceased estates.

- Article 4(1) and Schedule 1 paragraph 20 DPO 1986 modify this order for deceased estates: reasonable funeral, testamentary, and administration expenses take absolute priority.
- In practice, the hierarchy is:
  1. Funeral/testamentary/admin expenses;
  2. Secured creditors;
  3. Preferential debts (wages, HMRC, pensions);
  4. Ordinary unsecured;
  5. Interest;
  6. Deferred debts;
  7. Surplus.

# Backdating and Void Dispositions

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- When an Insolvency Administration Order (**IAO**) is made, the deceased's property vests in the trustee as if from the date of death. Any post-death dispositions may be void unless validated by the court.
- Relevant case law:
  - *Re Vos (Deceased)* [2006] EWHC 1419 (Ch);
  - *Williams v Lawrence* [2011] EWCA Civ 1428.
- This rule protects creditors by preventing asset dissipation. PRs should seek validation orders for payments made after death and before the **IAO**.

# Contingent or Disputed Liabilities

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- Section 382 IA 1986 ensures that contingent and future debts are provable in insolvency. PRs must therefore treat such liabilities as part of the estate's obligations.
- Key cases:
  - Re Yorke (Deceased) [1997] 1 WLR 1372;
  - Re K (Deceased) [2007] EWHC 1260 (Ch);
  - NatWest v Lucas (Savile Estate) [2014] EWHC 653 (Ch).
- Best practice:
  - (1) Publish Trustee Act 1925 s.27 notices in London Gazette etc;
  - (2) Retain funds for contingent claims;
  - (3) Apply for court directions if uncertainty persists;
  - (4) Keep full records for protection under s.61 Trustee Act 1925.

# Checklist for Personal Representatives

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1. Assess solvency before taking the grant; renounce if insolvency is clear.
2. Prepare full inventory of assets and liabilities, including contingent debts.
3. Classify debts according to statutory hierarchy (DPO 1986 Art 4, IA 1986 ss 328–330).
4. Publish s.27 Trustee Act 1925 notices to notify creditors.

NB: a Gazette advertisement does not exclude liability for a claim of which representatives have actual knowledge, even if they have genuinely forgotten of the existence of the claim

5. Keep funeral and administration expenses reasonable and fully evidenced.
6. Obtain court directions or Beddow order if uncertain about payments or disputes.
7. Maintain a detailed record of every decision, valuation, and payment.
8. Cooperate fully with trustee if IAO granted and transfer documents promptly.



# Seminar Discussion Points?

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- Should PRs routinely seek IAOs for protection or is this disproportionate?
- How far does s.61 Trustee Act 1925 excuse honest but technically incorrect distributions?
- Is retrospective voiding justified to protect creditors or unfair to diligent PRs?
- Should 'reasonable' funeral and administration costs be codified to reduce litigation risk?
- Has HMRC's restored secondary preference distorted equality among unsecured creditors?
- Should the **DPO 1986** be modernised to address digital assets and contemporary insolvency practice?