

## FOURTEEN

How do you effectively help clients facing bankruptcy and divorce, what do you do if you think the bankruptcy is a manipulation?



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“Failure is only the end if you  
decide to stop”\*

- Richard Branson  
(Entrepreneur)

\*“or you are declared bankrupt”

-Chris Miller

(Cynic)

# 1. Some basic concepts

- All assets of the bankrupt (save for tools of trade, domestic essentials, most pensions, property held on trust, personal actions and some foreign assets) vest automatically in the trustee in bankruptcy
- The Insolvency Court can order that a bankrupt's income is used to service debts (subject to reasonable domestic needs being met)
- A creditor or a bankrupt person themselves can petition for bankruptcy

- Joint tenancies are automatically severed by the bankruptcy
- A bankruptcy order will usually last for 12 months, but the assets remain vested in the trustee after the 12 months (and the trustee can apply for an extension in any event)
- The Insolvency Court has the power to stay Family Court proceedings whilst a bankruptcy petition is pending

- The trustee can apply to intervene in family proceedings (but should not routinely do so; *Albert v Albert* [1992] 2 FLR 791)
- Minimum debt of £5,000
- The Insolvency Court has broad powers including ordering third parties to provide disclosure and the ability to set aside certain transactions

- **Any** disposition between petition and the assets vesting in the trustee in bankruptcy is void unless made with permission of the Insolvency Court or it is subsequently ratified by the Insolvency Court
- The non-bankrupt spouse is not an automatic party to the insolvency proceedings (but may apply to become one)

- Bankruptcy dealt with by the Chancery Division
- Main statutory provision is the Insolvency Act 1986
- Procedure governed by the Insolvency Rules 2016:  
<https://www.legislation.gov.uk/ukSI/2016/1024/contents/made>

## 2. Genuine Bankruptcies

*“Capitalism without bankruptcy is like Christianity without hell”*

- Frank Borman  
(Astronaut and Entrepreneur)

# a) General

- Timing is very important
  - Pre-petition
  - Post petition, pre-vesting
  - Post vesting
- Plan ahead
- Be aware of pitfalls
- Where possible, work collaboratively with the other spouse

- Advise clients of the roadmap ahead (failure to do so may amount to negligence; Burke v Chapman [2008] EWHC 341)
- Consider working/ advising in tandem with insolvency specialists
- Consider working collaboratively with the trustees in bankruptcy/ Insolvency Court

## b) Before Petition

- The Insolvency Court has wide powers (s339-340 IA 1986) to set aside transfers or conveyances of assets that took place up to 5 years prior to petition. Different 'bands' of timing apply:
  - 6 months prior to petition (or 2 years if recipient of transaction was connected to the company). Set aside as a 'preference' if intention and effect was to produce a preferred creditor status for a simple creditor

- 2 years (or 5 years if recipient is an ‘associate’) if the transaction is ‘significantly less’ than the value in money or money’s worth
  - More than 5 years. At this point the only basis for a creditor seeking an avoidance will be fraud, which ‘unravels all’; s423 IA 1986
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- So what are the steps that can be taken with this in mind?

- Reach settlement and get it approved by the Court
  - Hill v Haines [2008] 1 FLR 1192; a *bona fides* financial remedy order provides ‘consideration’ for the assets transferred,
  - Intra- or post-nuptial agreements (actioned, but not ratified by the Court) can also potentially help; Papanicola v Fagan [2008] EWHC 3348
  - Be explicit in the order as to the reasoning behind transfers and what has been ‘given up’ by the receiving spouse

– BUT:

- Collusion to put assets beyond the reach of creditors is susceptible to being set aside; Re Jones [2008] 2 FLR 1969
- Dispositions as part of a final FR order based on an undervaluation of a matrimonial asset are also capable of being avoided; Segal v Pasram [2004] EWHC 3315
- Unactioned pre-, intra- or post-nuptial settlements will not have a protective function (the Family Court can only divide what is available for distribution; Albert v Albert)

- Clarify (formally) beneficial interests in property:
  - Legal title of property held on trust does not form part of the estate in bankruptcy;
  - The onus is on the trustee/ creditors to apply to the Court to determine that the beneficial ownership is not as formally declared,
  - Be transparent as to why the clarification has taken place and on the basis of what evidence
  - Be consistent! See; *Supperstone v Hirst* [2005] EWHC 1309

- Consider imaginative use of settlement of trusts powers under s24(b) MCA 1973
  - If a spouse might be declared bankrupt in the foreseeable future, then it may be possible to make provision by way of a trust so that the property does not fall into the estate in the event of bankruptcy
  - For an analogous approach, see Re Abram [1996] 2 FLR 379

- Consider if s37 of MCA 1973 can help?
  - Freezing an asset does not stop it forming part of the estate in bankruptcy; *Cretanor Maritime v Irish Marine Management* [1978] 1 WLR 966
  - But, one of the (wide ranging) powers of the Family Court under s37 is to require monies to be paid into Court or to a specific account (with a view to it being held to order of the Court)

- This money does not form part of the estate in bankruptcy; *Sheratt v John Bromley (Church Stretton) Ltd* [1985] 1 QB 1038 and *Flightline Ltd v Edwards* [2003] EWCA Civ 63
- NB money paid to a solicitor in order to secure the lifting of a freezing order will not generally be protected in this way; *Flightline Ltd*

- Even if assets cannot be protected using the above methods, consider obtaining secured provision for your client in order that they can be treated as a preferred creditor by the trustees in bankruptcy
- Consider capitalising maintenance (the income stream may be about to 'dry up' or be diverted to pay the creditors). Be explicit about the basis of capitalisation in the order

- Pensions
  - Don't stop making pension contributions!
  - Consider whether or not a pension offset will mean that more assets are preserved overall (if a pension offset can be justified for reasons other than denying creditors)? As always, be very careful before encouraging the client to opt for a pension offset.

## c) Post petition, pre-vesting

- Any transactions will be void (s284 IA 1986)
- However, prospective permission for a transfer can be obtained from the Insolvency Court
- Transactions can also subsequently be ratified
  - This will be easiest to argue where the receiving spouse is a secured creditor (see e.g. Re Mordant [1996]1 FLR 334)
  - Where the transfer does not disadvantage creditors, then ordinarily one would expect it to be ratified

## d) Post vesting

- Property acquired by the bankrupt person after the Bankruptcy order does not automatically form part of the estate (but can be included on application by the trustee s307 IA 1986)
- Challenges can be made (in the Insolvency Court) to the trustee's view as to what forms part of the estate in bankruptcy

- The non-bankrupt spouse may be able to make a claim as a creditor, whether ‘preferred’ or otherwise (although they may not be able to recover the full amount, depending on the size of the estate and the amount owed to creditors)
- Consider equitable accounting arguments. Has the non-bankrupt spouse taken on debt which ultimately is to the benefit of the creditors?

# 3. Dubious Bankruptcies

- As with genuine bankruptcies, forward planning is essential
- Can s37 MCA 1973 powers be used preemptively?
- Are there grounds to apply for a stay on a petition?
- Will an application under ToLATA 1996 assist?

- What if the bankruptcy order has already been made?
- Section 37 MCA 1973 does not provide the Family Court with power to set aside a bankruptcy order, however fraudulently it might have been obtained; Woodley v Woodley [1993] 2 FLR 477
- However, the Insolvency Court has power to annul a bankruptcy order; s282 IA 1986

- Procedure to follow:
  - EITHER
    - Make an application to the Insolvency Court to intervene and to annul the bankruptcy; OR,
    - Make an application to the Family Court to transfer to the High Court (if not already there) and simultaneously make an application to the Insolvency Court to transfer the bankruptcy proceedings to the Family Division pursuant to r7.11 of the Insolvency Rules 1986

- DO NOT invite the Family Court to transfer the insolvency proceedings, there is no jurisdiction to do so; Arif v Zar [2012] EWCA Civ 986
- DO check the Insolvency Rules 2016 and CPR 1998 to ensure that you are using the correct forms and procedure
- As a preliminary step, consider seeking disclosure of the evidence within the bankruptcy proceedings to establish whether or not grounds for annulment arise

- Grounds for annulment (see s282 IA 1986):
  - The order ought not to have been made at the time that it was made
  - The debts and expenses have all been paid or secured to the satisfaction of the Insolvency Court
- Generally speaking the first ground will be satisfied if it can be demonstrated that the Husband under declared his assets at the time that the petition was presented (and the debts have not increased beyond the capacity to pay at the time that the application to annul is made; *Mekarska v Ruiz* [2011] EWHC 913)

# 4. Concluding thoughts

- Try to 'scan the horizon' for potential bankruptcy issues
- Provide focused advice early on
- Avoid delay where bankruptcy is likely to be an issue
- Remember that the Insolvency Court regards the obligations to creditors as compelling and the impoverishment of the spouses as oftentimes being a necessary consequence of a capitalist system

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