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Financial difficulties in divorce:

How do you protect a client who is faced with a spouse who is in difficult financial circumstances, i.e. pending bankruptcy or in negative equity (and intending to allow the former matrimonial home to be repossessed by the lender)?

Introduction

In this talk, I will look at what we, as practitioners, can do where our client's spouse is in financial difficulties, whether real or being used as a means to defeat a claim for financial provision on divorce.

To assist with highlighting the typical problems which arise, I will use some fictional scenarios featuring a separated couple called Angie and Bradley. I will consider the legislation and the possible options and remedies available.

I will cover Court based remedies and then move on to look at negotiated settlements. Finally, I will summarise with some tips and pointers, hopefully to help you help your clients make the best decisions possible in difficult circumstances.

1. **You have met with your new client, Angie. She explains that she has recently separated from her husband Bradley. Bradley has always been secretive about his finances and Angie suspects he**

may have a number of debts. They have a jointly owned matrimonial home and mortgage. She wishes to make financial claims against him on divorce, although she is very worried about his precarious financial position. She wishes to establish whether it would be a viable option to seek financial provision in light of his circumstances?

Angie's position will really depend upon whether or not Bradley is genuinely in financial difficulties or is just chancing his luck. To help you assess that, you should investigate so far as you can the extent of his resources and liabilities.

If Bradley is indeed in dire straits financially with bankruptcy on the horizon, you need to consider what can be done to protect Angie's position. This may involve some lateral thinking.

For example, if Angie is aware that Bradley is about to be sued for non-payment of a debt, for example by HMRC for non-payment of a tax liability, Angie could, if she had the resources to do so, make payment of the sum due by Bradley to HMRC. Then, the interest of HMRC in sequestrating Bradley disappears.

Although in this scenario the debt has been paid by Angie post separation and is not therefore a matrimonial liability, it would be possible for her to refer to this in the divorce action. She could argue that she has suffered an economic disadvantage to Bradley's economic advantage.

This would, however, only be an option if Angie has access to financial resources to make payment to Bradley's creditors.

2. What happens if Angie does not have sufficient resources to pay Bradley's creditors?

Here, unfortunately, there may be nothing you can do unless there is another means of discharging the liability which Bradley has incurred. He may be sequestrated.

3. What happens if Bradley ceases making payment of the mortgage over the jointly owned family home?

If mortgage payments are not being met, Angie should contact the mortgage lender as soon as possible. If it is a repayment mortgage, see if it could be switched to an interest only mortgage, or agree a payment holiday or mortgage break.

She could also consider raising a Divorce Action and seek an Incidental Order ordaining Bradley to make payment of the mortgage over the matrimonial home, or alternatively a claim for interim aliment.

I have a case at the moment, where parties are unable to pay the mortgage. The parties have agreed to sell the property. The lender has agreed to hold off enforcement action, on the basis that the house is being marketed for sale and the parties are continuing to keep the lender updated.

4. **What happens if Angie tells you that Bradley is so angry about the separation that he has said he will make sure she gets nothing even if it means he bankrupts himself?**

Here we are faced with someone who is deliberately trying to thwart Angie's right to a fair division of matrimonial property. An example of such behaviour would be someone who deliberately enters into a trust deed, Debt Payment Plan or gets a friend to sequestrate them by claiming a debt is due. What can be done?

Bradley becomes bankrupt before you get a chance to do anything.

The issue in point here is whether Angie's claim for financial provision has already come into existence, because parties have separated. Leaving aside the issue of whether Bradley can try to argue in fact they have not….and assuming they have, does she have a valid claim which she can intimate to the trustee? I do not have a definitive answer for you and would be interested to hear your views later. However, I have spoken to a colleague who is an insolvency practitioner and his view is that this is akin to for example a pedestrian who is run over by an uninsured driver who then becomes bankrupt before the pedestrian can make a claim. His right to claim arose at the point when he was knocked down, meaning the right did exist at the point of sequestration, and in turn that a claim could be intimated to the trustee in sequestration.

Assuming Bradley is not yet bankrupt, can you raise a Divorce action?

The first question is whether Angie has a basis to raise divorce proceedings. The fact that Bradley is threatening to bankrupt himself hopefully means that there will be other examples of unreasonable behaviour. That would give you a means to raise divorce proceedings based on his unreasonable behaviour. As part of that, you would seek orders for financial provision.

What else might you seek within the Divorce action?

Seek an Interdict prohibiting Bradley from bankrupting himself?

You could seek an interdict prohibiting Bradley from entering into a voluntary arrangement whereby his estate is sequestrated. You might be concerned that this is not an interdictable offence and you would probably be right if we focus only on the common law position because there is no inherent illegality. However, shift the focus to Section 18 Under this, you are arguing that the remedy is required to prevent the defender transacting in such a way as to defeat your client's claims, in whole or in part.

I attempted to obtain an interdict in a case of mine where we realised that my client's husband was planning to enter into a debt payment plan under the debt arrangement scheme. In this case, I had already raised proceedings and the case was well advanced by the time we discovered his intention. I was not successful in getting the interdict but on reflection I should have focused more on the Section 18 aspect. Having spoken to Counsel about this issue, I think it is definitely worth trying in such situations.

Use section 18 to its full potential….seek other interim interdicts?

Such as to prevent a defender from selling, disposing of specific assets if you have a concern about that; or to prevent the defender or agents on his behalf (such as a firm of solicitors who are holding funds) from intromitting with any payment received by the defender; or frame the interdict more widely, to prevent any transaction that would have the effect of defeating in whole or in part the pursuer's claim for financial provision.

5. What if the Debt Payment Plan or a Trust Deed has already been entered into by Bradley?

If Bradley has entered into a protected trust deed, that is likely to have the effect of defeating in whole or in part a claim for financial provision, then seek to have it set aside, under s.18.

Warrants to Inhibit

Other steps to bear in mind are seeking warrants to inhibit (this prevents sale or disposal of or otherwise transacting with heritable property) and to arrest on the dependence (prevents defender from disposing of funds or goods held by a third party). This is useful both where there the defender is in genuine financial difficulty or where it is orchestrated. However, bear in mind that if the debtor is sequestrated the trustee can sell assets and ignore inhibitions and the fact of the inhibition no longer confers a preference on the inhibitor. The purpose of the inhibition would be to ensure that the asset was still available to a trustee, thus increasing any potential dividend.

Debtors (Scotland) Act 1987

The Debtors (Scotland) Act 1987, Section 15E sets out the test for the grant of warrants without a hearing first. Firstly, you need to have a prima facie case. Next, that there is a real and substantial risk that enforcement of any decree in the action in favour of the creditor would be defeated or prejudiced by reason of:

(a) the debtor being insolvent or verging on insolvency, or

(b) the likelihood of the debtor removing, disposing of, burdening, concealing or otherwise dealing with all or some of the debtor's estate.

Remember to enclose Form G4A with your Initial Writ in such situations. This is the statement to accompany the application for interim diligence. The Form G4A should be drafted carefully and include as much detail as you can.

Next, consider Incidental Orders in terms of Section 14 of Family Law (Sc) Act 1985

If you have any concerns that the spouse will become bankrupt (whether deliberately or otherwise), and if there is heritable property you should consider applying for an incidental order for sale under section 14 (2) (a) of the 1985 Act. If decree is granted, then your client will be in a stronger position. However, you must provide for what happens to the sale proceeds. It is not enough simply to seek sale. You should carefully frame the order you seek to avoid problems later on and given the opponent is unlikely to be keen to co-operate.

Therefore, within the crave for the sale of heritable property:

(a) Specify the appointment of the estate agents and conveyancing solicitor
(b) Ordain the parties to accept the first reasonable offer (as recommended by the estate agents for acceptance)
(c) Provide that in the event the Defender fails to sign any necessary Deeds, that the Sheriff Clerk or deputy Principal Clerk of Session can sign those Deeds on their behalf.
(d) Outline how the sale proceeds should be dealt with following sale.

We have done this in a case of ours, successfully obtaining incidental orders for sale of three properties. We had become concerned the Defender would be made bankrupt. That has now happened. In our case we said that the husband's share would be placed on joint deposit account pending further order of court. That left us with the option of negotiating with the trustee in sequestration, so far as concerning the husband's share.

The benefit of obtaining an Incidental Order providing for what happens to the sale proceeds is that if granted prior to sequestration it becomes a formal order. Your client then becomes a legitimate creditor as part of the sequestration.

Generally, frame your Writ very carefully. Your pleadings should include everything you can think of to highlight your client’s concerns about the risks of bankruptcy and where relevant the defender's conduct. The more detail you can add, the more likely you are to obtain the interim orders needed to protect your client's position so far as possible.

Consider carefully what orders for financial provision to seek…..

Aliment, Periodical Allowance & Child Maintenance

Consider seeking aliment or payment of an alimentary nature. A bankrupt's income after the date of sequestration does not vest in the trustee but remains the debtor's property. The trustee may however seek a contribution from his income. This contribution will be calculated with reference to what the debtor needs for his own reasonable living costs and for payment of aliment, periodical allowance and child maintenance.

Arrears of aliment at the point of sequestration will just fall into the sequestration, with your client ranking as an ordinary creditor. However, payments going forward are not struck out. When the debtor is discharged, this does not discharge him from any ongoing obligation to pay aliment, or any sum of an alimentary nature or periodical allowance that could not be claimed from the trustee (and assuming the amount has been quantified by decree or legally binding document such as a registered Minute of Agreement).

What do we mean by "payment of an alimentary nature"? In the case of *Lessani v Lessani 2007 FamLR 81,* the court accepted that part of the capital sum was of an alimentary nature because it had been calculated under reference to section 9 (1) (c) of the Family Law (Sc) Act 1985. So consider if you can aver that.

Pension Sharing

Consider seeking a pension share. Sequestration does not generally affect a pension, unless the trustee suspects excessive contributions

have been made into a pension scheme to protect assets from sequestration. So, it may be a safer option for your client if sequestration is considered to be a real risk.

6. What can you do if Bradley becomes bankrupt during the course of proceedings, no Incidental Orders have been obtained, but Decree has <u>not</u> been granted?

This is potentially a serious problem. Your client's claim for financial provision is a contingent debt capable of existing at the date of separation (per the case of Crighton's Trustee v Crighton 1999 SLT (Sh Ct) 113). It is contingent upon decree of divorce being granted and orders being made.

However, the claim must be pursued ie a claim must be made in the sequestration as otherwise it will be lost. This is because when a debtor is discharged, s/he is discharged from all debts and obligations that exist at the date of sequestration. Therefore, pursuing a contingent debt against the trustee is essential in order to protect Angie's position. You should give the trustee as much information as you can about your client's claims, particularly the basis for them. The trustee may then decide to take advice from a family lawyer about the strength or otherwise of your claim. The trustee might decide to come into the divorce action, though that is perhaps less likely if your client only seeks half of the net value of the matrimonial property.

If pursued correctly Angie's claim will rank alongside all the other creditors. Angie should be advised that she may well not receive the

full amount sought, depending on the extent of the sums owed to other creditors as part of the sequestration as set off against the value of the debtor's estate.

What do you do about the Divorce action?

The way to put beyond doubt the sum owed to your client is to go to Proof and get decree, which you can then exhibit to the trustee. In parallel with proceeding to proof, though, you need to find out from the trustee what is owed to other creditors and the prospects of recovery since there is no sense in exposing your client to the expense of proof unless the risk to reward ratio is good.

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7. **Even where Decree has have been granted providing for financial provision in favour of Angie, are the terms of the Decree open to scrutiny due to Bradley's sequestration?**

Section 100 of the Bankruptcy (Scotland) Act 2016 provides legislation for the recall of an order made on divorce/dissolution. This covers orders for payment of capital sum; transfer of property; pension sharing order.

This could be a risk for Angie if on the date of making of the order, Bradley was absolutely insolvent or was rendered so by implementation of the order and within 5 years of making of the order, Bradley's estate has been sequestrated or he has entered into a trust deed which has been protected. In terms of determining whether an order should be granted, the court must have regard to all of the circumstances of the case.

If successful, the orders granted on Divorce can be recalled with repayment being ordered or the return of property required.

What can you do to avoid the risk of this? Ironically, the better you do for your client, the more at risk she may be. However, having spoken to an insolvency colleague at my firm, I understand challenges under this section are very rare. His view was that most insolvency practitioners will not be inclined to challenge a court order granted especially if the court has heard evidence, plus unless there is a suspicion of collusion a court would be reluctant to interfere with an earlier order.

Key Considerations:

(a) If you are concerned about the solvency of the other party, warn your client before decree is granted, if only for risk management reasons.

(b) Consider whether it might be better to seek a pension share rather than a capital sum. There is possibly less risk of a trustee seeking recall of a pension sharing order unless they have plans to seek recovery of excessive pension contribution. Pension rights do not vest in trustees so a trustee would have no interest in challenging a pension sharing order per se.

(c) Consider whether what you are seeking might tip the person into insolvency, or give them an excuse to opt for that. An example would be where in order to pay your client a capital sum the Defender must realise assets which will give rise to a significant CGT liability. The court will of course have to consider resources when deciding whether to grant the orders you seek, so you would think the defender would flag up at that stage if at risk of insolvency/CGT

issues. Failure to do so, followed by becoming bankrupt might suggest the defender was deliberately trying to avoid payment.

8. Which leads me on to….What do you do if Angie has obtained decree for financial provision, the parties are divorced but then Bradley does his utmost to avoid payment?

In a case of mine, we successfully obtained orders for financial provision including payment of a capital sum whereupon after divorce the husband applied to enter into a Debt Payment Plan under the Debt Arrangement Scheme. He had a property rental portfolio from which he derived good income so of course he did not want to declare himself bankrupt. A DPP would have the merit for him of allowing him to keep his properties. A DPP is sent to creditors for approval. As my client had decree for financial provision she was one of his creditors (along with various firms of solicitors he had failed to pay along the way).

You must respond to the request for consent within 21 days or you are deemed to consent. I objected and the DPP was not approved. Success? No, because he then failed to pay my client the capital sum ordered. So, we petitioned for his sequestration. At the eleventh hour he paid up. In effect, we turned the tables on him by petitioning for his sequestration, and were successful in getting payment. He is due to pay the second instalment of capital next May. It is quite possible that between now and then he will take steps to make himself bankrupt or that we will have to petition again for his sequestration to compel payment. If he does become bankrupt then my client will rank as an ordinary creditor in the same way as his other creditors. We did try to

turn her into a secured creditor by getting a security granted over property belonging to her husband; however, although he has a property rental portfolio, the properties are all subject to borrowing and the lender would not consent to a security in favour of my client.

9. What if Angie and Bradley's family home is at risk?

Section 113 of the Bankruptcy (Scotland) Act 2016 provides some protection in relation to the family home. The trustee in sequestration must obtain the consent of the debtor's spouse (Angie) and in the absence of consent, the trustee must apply to the sheriff before he can sell the house. The sheriff may refuse the application for authority to sell or may postpone for up to three years.

Bear in mind also the provisions of section 114 of the Bankruptcy (Scotland) Act 2016 which provides some protection for a non-entitled spouse on sequestration. Where a trustee is aware there is a debtor who has a spouse with occupancy rights (the non-entitled spouse), then the trustee must write to the wife to inform her of her right to apply for recall of the sequestration and if she thinks it was done to defeat her entitlement. However, this only applies to a non-entitled spouse. There is no similar provision for an entitled spouse who believes their husband has deliberately made himself bankrupt in order to defeat their claim for occupancy rights.

10. Negotiated Settlements (Minutes of Agreement) - What can you do here, where Angie is worried about Bradley's financial position?

Firstly, why is this a concern? There could be a risk that the terms of settlement in your client's favour could be viewed as "gratuitous alienations" (transfer for no or inadequate consideration) if Bradley becomes sequestrated after a Minute of Agreement has been entered in situations whereby for example, a transfer of property has taken place for no or inadequate consideration. This risk subsists for up to 5 years following the date of the alienation. Therefore there is a lengthy period of risk post date of alienation for Angie.

Bear in mind that the date of alienation is the date when your client receives the asset, for example when she gets the house sale proceeds or the date when the property is transferred to her and registered in the Land Register. It is not the date of signature of the Minute of Agreement.

11. Angie and Bradley have reached mutual agreement and wish to enter a broadbrush settlement. Angie instructs you to prepare a Minute of Agreement regulating settlement providing that Bradley transfers his share of the title in the Matrimonial home to her for no consideration. She is adamant that she does not want you to undertake any investigation of the assets or their value because that will just cost her more money. Could this be risky for Angie?

Section 98 of the Bankruptcy (Scotland) Act 2016 could be applicable here. Section 98 (5) states if alienation is proven, the Court must grant decree for reduction or restoration of property to the debtor's estate or such other redress as may be appropriate.

12. What are the risks for Angie here, if the terms of settlement and Bradley's actions are determined to be a gratuitous alienation?

The worst case is that the asset is restored to Bradley's estate. For example if Bradley transferred a house owned solely by him to Angie, then she would need to transfer the house back to the debtor's estate. If Angie refused to co-operate, the trustee would raise an action for division and sale.

If the house had been sold and Angie had received all of the proceeds then the trustee could sue her for the sums received, probably with interest running from the date the money was asked for until payment.

13. Are there defences open to Angie to protect her settlement?

There are 3 defences listed at section 98 (6) of the Bankruptcy (Sc) Act 2016.

(a) The first defence is that immediately or at any other time, after the alienation, the debtor's assets were greater than the debtor's liabilities. The debtor's asset position is looked at on a balance sheet basis i.e. if the debtor's assets are more than his liabilities then he is solvent. It can be hard to work out the position and the onus is on the person wanting to prove the defence to show that the debtor was solvent. So, and even if you did manage to negotiate a settlement, if you have an ex-spouse who is not particularly willing to

help out the other, as is pretty usual, this may be a hard test for your client to prove. Getting an affidavit by the debtor declaring himself solvent as part of the conveyancing where for example a half share of a house is being transferred is not really worth anything because Angie still needs to prove the section 98(6) defence.

(b) The second defence is that the alienation was made for adequate consideration. This does not mean the best price that can be achieved but what is a reasonable price. So, if you can show that you investigated the value of the matrimonial property and that the settlement your client achieved could be justified according to the Section 9 principles, then this will help your client. Therefore, where you have any concerns about the other person's solvency, make sure you keep careful records on your file. The problem is of course if the settlement is on a broadbrush basis. Here, all you can do is highlight to your client the risks before he or she signs the Minute of Agreement.

(c) The third defence is that the alienation was a gift, for example birthday or Christmas or other conventional gift and it was reasonable for the debtor to make. For example, expensive jewellery gifted to your client by her spouse which she is keeping as part of the overall settlement.

14. To sum up, where your client's spouse is in financial difficulties whether real or orchestrated, I would suggests you consider the following (non exhaustive) key points:

(a) Find out from your client about their spouse's financial position at the outset.

(b) Keep asking about their position during the course of proceedings, so you know when to take action and what action best to take.

(c) Get things done as soon as possible, deal with challenges later on.

(d) Keep good records (with supporting vouching/evidence) so that you can hopefully show that any settlement was entered for adequate consideration, i.e. fair sharing of the matrimonial assets and from a risk management perspective, show that you have made your client aware of the risks – e.g. gratuitous alienation.

(e) Advise your client to consider taking a less favourable settlement if it leaves the husband solvent at the date of settlement.

(f) Consider more aliment or capital of an alimentary nature, less straight capital.

(g) Consider getting a security granted in your client's favour to strengthen her claim for payment of capital. Then she will rank as as a secured rather than an ordinary creditor. Be careful though; if the security is granted and registered within six months before the date of sequestration, it is challengeable as an unfair preference (in terms of section 99 of the 2016 Act).

(h) Get advice from an insolvency practitioner.

(i) If the worst happens, and the spouse is sequestrated, keep in regular contact with the trustee and pursue your client's claim that way. Mind the time limit for intimating claims to the trustee.

(j) If you think the spouse might be trying to enter into a DPP etc, check the Register of Insolvencies regularly.

15. Conclusion

Keep calm. Bear in mind depending on when the client initially seeks advice and the extent of their spouse's financial difficulties, there may a limited amount that can be done.

Ingather as much information as possible at the outset and take into account the key points just mentioned.

That way hopefully you can protect your client from ending up in the unfortunate situation of a diminished financial settlement on divorce.