

PROTECTING YOUR CLIENT FROM THE IMPACT OF A BANKRUPT SPOUSE: THE LEGAL FRAMEWORK

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Bankruptcy – Overview

1. A petition may be issued by either the debtor himself (Insolvency Act 1986 s.272) or creditors who are owed more than £750 as a result of the debtor's failure to comply with a court order or statutory demand (s.267). Once the order is made, the bankrupt's assets (subject to certain exceptions in s.283, including for domestic or personal items necessary for the bankrupt's business) vest initially in the official receiver until the appointment of a trustee in bankruptcy (usually an accountant) who will then administer the estate so as to satisfy the claims of the bankrupt's creditors who have so-called provable debts as best as he is able until such time as the bankruptcy order is discharged (s.305-306).
2. Following discharge the bankrupt is no longer liable for the balance of the debts (s.281). The trustee's professional costs (including any disbursements for legal representation) are paid out of the bankrupt's estate.

What financial remedies can be ordered against a bankrupt?

3. Property adjustment orders cannot be made save for a residue of sale proceeds following discharge of the bankruptcy (see Ram v Ram (No.2)[2004] EWCA Civ 1684 [2005] 2 FLR 75).
4. Lump sums can only be ordered in respect of residue of the estate once the bankruptcy is discharged provided the judge has a clear picture of what the assets will

be in the future (Hellyer v Hellyer [1996] 2 FLR 579 (CA)) or where the lump sum is to be paid from income (Re G (Children Act 1989 Schedule 1) [1996] 2 FLR 171).

5. Pensions rights do not vest in the trustee, therefore they will normally be available as the subject of pension sharing or attachment orders (Welfare Reform and Pensions Act 1999 s.11-12).
6. Periodical payments can be ordered against a bankrupt, although during the currency of the bankruptcy the assessment of quantum is not binding on the bankruptcy court, which can make an income payments order which will override the periodical payments order. The income payments order must provide for the reasonable domestic needs of the bankrupt and his family. It can last until up to three years after the discharge of the bankruptcy (Insolvency Act 1986 s.310).
7. It should be noted that subsequent discharge from bankruptcy does not release the bankrupt from a debt arising from an order in family proceedings or a CSA maintenance calculation (Insolvency Act 1986 s.281(5)).

Bankruptcy Between a Final Order and Implementation

8. This applies to a situation where you have a consent order, possibly where there are sufficient assets from which to meet your client's housing needs despite the other spouse's high levels of personal debt. Is your client safe from the reach of bankruptcy post order?
9. Property Adjustment Orders confer an equitable interest **from the time the order takes effect** (DA) see Hill v. Haines [2008] 1 FLR 1192 (CA).

10. Lump sums are different – the beneficial interest in the money which one party is ordered to pay to the other does **not** pass at the moment the order takes effect see Burton v Burton [1986] 2 FLR 419.
11. Even if your final order is implemented prior to bankruptcy that does not necessarily mean that the disposition is protected. The TiB has two ways of retrieving money for the benefit of creditors:
- i. Transactions at an undervalue (s. 339);
 - ii. Preferences (s.340)
12. S339: *'where an individual is adjudged bankrupt and he has, at a relevant time, entered into a transaction with any person at an undervalue, the trustee of the bankrupt's estate may apply to the court for an order under this section'*
13. The 'relevant time' is 5 years prior to the presentation of the bankruptcy petition, if at the time of the transaction the person was insolvent or became insolvent as a result of the transaction. These requirements are presumed to be met in the case of a transaction at an undervalue if entered into with a spouse.
14. The definition of 'an undervalue' is at S339(3):
- '(a) A gift... on terms that provide for him to receive no consideration;*
(b) a transaction.... For consideration the value of which, in money or money's worth, is significantly less than the value of... the consideration provided'
15. 'Preferences' as per s.340 *'where an individual is adjudged bankrupt and he has at a relevant time given preference to any person'*. Where the transferee is a spouse the relevant time is 2 years. Where it is not a spouse the time is 6 months. It is also a requirement the transferor was at that time insolvent or made insolvent as a result of the transaction.

16. If the TiB is successful in demonstrating the undervalue or preference the court '*shall make such order as it thinks fit for restoring the position to what it would have been*' [s.339(2); s340(2)]. The Court therefore has a discretion - see Claridge v Claridge [2011] EWHC 2047 (Ch), where the Court found that there had been a transaction at undervalue but declined to make an order. In Singla v Brown [2008] 2 FLR 125, the court also made no order where the bankrupt had accepted a notice from his partner reducing his interest in their home, but in circumstances where he had made no capital contribution or mortgage payments, and was a co-owner simply because the mortgagee required it.
17. In Segal v Parstam and another [2008] 1 FLR 271 (Ch D), H and W executed a deed purporting to transfer H's half share in the FMH to W for £1,000 and her forgoing her ancillary relief claims. H was made bankrupt 8 months later. After a delay of 6 years the TiB sought to have the transfer set aside. It was held that the limitation period for recovery of a real property by a TiB is 12 years.
18. In Hill v. Haines (above), it was clear at the time of the final hearing that H would become bankrupt. The DJ made an order transferring H's share in the FMH to W within 7 days of DA. H did not execute the transfer and was made bankrupt shortly thereafter. The DJ subsequently executed the transfer documents. The TiB applied to set the transfer aside as a transaction at undervalue, succeeding in the Chancery Division in a decision subsequently overturned by the Court of Appeal who held that:
- a. The disposition was made at the time the order took effect;
 - b. **The compromise of ancillary relief claims does amount to consideration;**
 - c. Absent the usual vitiating factors the compromise of a party's statutory rights would be balanced by the payment of money or transfer of property i.e. this was not at an undervalue;

- d. If the ancillary relief order was the product of collusion between the spouses designed to adversely affect creditors then the order would be set aside [see Ball v Jones [2008] 2 FLR 1969];
- e. An agreement to compromise ancillary relief proceedings cannot constitute a transaction for the purposes of s.339.

Annulment

19. A key consideration for the non-bankrupt spouse will be whether to apply to annul the bankruptcy, particularly in circumstances where they may allege that it is a ploy/not genuine.

20. Section.282(1) of the Insolvency Act 1986 reads:

The court may annul a bankruptcy order if it at any time appears to the court –

(a) that, on any grounds existing at the time the order was made, the order ought not to have been made, or

(b) that, to the extent required by the rules, the bankruptcy debts and the expenses of the bankruptcy have all, since the making of the order, been either paid or secured for to the satisfaction of the court.

21. For practical purposes, family practitioners are likely to be concerned only with ground

(a). It is important to note that the word 'may' in s.282(1) confers a discretion on the court whether to annul or not. To summarise the principles set out in the relevant case law, in deciding whether to annul a bankruptcy order, the court is likely to consider the following:

(a) Should the bankruptcy order have been made in the first place? (if the answer is 'yes' then that is the end of the matter);

(b) If not, should the court exercise its discretion not to annul, taking into account the following non-exhaustive factors:

- (i) Whether the bankruptcy was tactical or an abuse of process;*
- (ii) Delay in making the application;*
- (iii) Likely effect of the annulment on the applicant and the bankrupt (who are unlikely to be the same person in a family law context);*
- (iv) Whether the debtor will be able to meet his liabilities;*
- (v) What provision is made for the trustee in bankruptcy's costs.*

22. The first question is whether the order should have been made in the first place. The relevant ground for a bankruptcy order under s.272(1) of the Insolvency Act is that the debtor is unable to pay his debts. Some clarification was provided by Lord Justice Wilson (as he then was) in [Paulin v Paulin](#) [2009] EWCA Civ 221 [2009] 2 FLR 354 at [41]. Wilson LJ explained that the relevant test is not balance sheet insolvency (whether the bankrupt's liabilities outweighed his debts) but rather commercial insolvency (whether he could meet his liabilities as they fell due). Wilson LJ went on to quote David Oliver QC sitting as a deputy High Court judge in *Re Coney (A Bankrupt)* [1998] BPIR 333 at 335-336:

"Inability to pay one's debts, at least in the context of insolvency, has historically long been construed as an inability to pay one's debts at the time they are due... it would not normally be right to annul a bankruptcy order unless at least it is shown that as at the date of the order the debtor was in fact able to pay his debts, or had some tangible and immediate prospect of being so able..."

23. Wilson LJ suggested that the burden of proof lies with the person seeking the annulment unless the bankrupt's assets outweighed his liabilities at the date of the bankruptcy.

24. In Mekarska v Ruiz & Boydon [2011] EWHC 913 (Fam), although the value of the former matrimonial home vastly eclipsed the husband's debts, the judge found that there was no tangible and immediate prospect of him being able to pay off those debts. His Lordship suggested that an immediate annulment application coupled with an acknowledgment that the former matrimonial home had to be sold rapidly might have altered this conclusion, but as things were there were no grounds upon which the court could annul (at [82]).
25. Even if it is found that the bankruptcy order should not have been made, the court still retains a discretion not to annul. In Paulin, Wilson LJ sought guidance from the words of Mr Justice Walker in Artman v Artman [1996] BPIR 511:
- "The statutes does not lay down any particular matters to be taken into account in the exercise of the court's discretion, but the likely effect of any annulment order on the applicant, on the bankrupt where he is not the applicant, and on the bankrupt's other creditors must, it seems to me, be among the most important matters to be taken into account. So must any element of abuse of process in the obtaining ...of the bankruptcy order."*
26. Other bankruptcy authorities suggest that a critical factor is whether the debtor would be able to meet his liabilities if the bankruptcy was annulled (e.g. Owo-Sampson v Barclays Bank & Boyden [2003] EWCA Civ 714 [2003] BPIR 1373 per Carnwath LJ at [35]).
27. One of the key questions is whether the bankruptcy was tactical. In Paulin v Paulin, a bankruptcy order which affected ancillary relief proceedings was annulled. In that case, the husband manufactured a debt in order to procure his own bankruptcy with the intention of defeating his wife's claims. By contrast, in Mekarska v Ruiz the judge found that the bankruptcy was not tactical but rather motivated by the husband's belated wish to put his affairs in order (at [82]).

28. Peter Jackson J held that, even if the initial hurdle in s.272(1)(a) had been crossed, he would not have exercised his discretion to annul. This was partly because the wife's resistance to the sale of the home caused 'a scale of expense that was beyond the normal powers of foresight', partly because the creditors would not be paid if there was an annulment, and partly because there was no basis on which to deprive the trustee of his costs and therefore any residue would be insufficient to re-house the wife and child in any case (see [84]).
29. **Delay was also clearly an important factor.** The wife's solicitors had threatened to apply to annul several months before the final hearing in the ancillary relief case. As it happened, the annulment application was not made until 18 months after the final hearing. **It is critical any application to annul is made as soon as possible.**

Which Court?

30. In Arif v Zar and Rehan [2012] EWCA Civ 986 Mostyn J had invited the High Court bankruptcy registrar to transfer the wife's annulment application to the Family Division to be heard with the wife's application for a financial remedy order. The registrar declined to do so and Mostyn J at a further hearing himself transferred the annulment application to the Family Division. Although the power to transfer proceedings between the divisions of the High Court under CPR r 30.5 is general, the power of a HCJ of one division to transfer proceedings involving an estate in bankruptcy into that division of his own motion under the Insolvency Rules does not extend to an annulment application.
31. The family court has no jurisdiction to deal with bankruptcy cases. Under the IR the power to transfer proceedings to another court relates only to transfers between the county court and the High Court or between different county courts. Since 22 April 2014 the family court and the county court are separate courts.

32. Where the financial remedy application and the bankruptcy proceedings are both in the High Court an application will have to be made to the bankruptcy registrar to transfer the annulment application to the Family Division, as was done in Arif.
33. In some courts outside London judges have dual jurisdiction in the county court and family court and are sitting in the same building. An application to annul a bankruptcy order would have to be issued in the county court where the bankruptcy order was made and it might be possible to have the financial remedy proceedings, including the application to annul, heard by the same judge.
34. The other possible way of achieving the hearing of the annulment application and the financial remedy application to the High Court and apply to the bankruptcy court to transfer to the High Court Family Division.

TRUSTEES COSTS

35. One of the most damaging effects of a bankruptcy order is that the trustee in bankruptcy's costs are deducted from the bankrupt's estate before any residue can be paid out to a spouse claiming a financial remedy. In Mekarska v Ruiz this caused the entire 'pot' to be wiped out (the costs were so high because the wife had resisted the sale of the matrimonial home which caused further litigation).
36. If the bankruptcy order is annulled it will normally be conditional upon the trustee's costs being paid from the estate.
37. Even where the person applying for the annulment has been wrongly affected by the order, any delay in making the application may result in the trustee's costs coming from the estate (e.g. LB Redbridge v Mustafa [2010] EWHC 1105 (Ch) [2010] BPIR 893, in which there was an 18-month delay). Moreover, the fact that the bankrupt spouse wrongfully obtained a bankruptcy order does not mean that the trustee should be denied his costs (Thornhill v Atherton [2004] EWCA 1858 [2005] BPIR 437). What is required is that the bankruptcy was an abuse of process and the trustee himself acted

improperly (see [Ella v Ella](#) [2008] EWHC 3258 (Ch) [2009] BPIR 441 for an example of an annulment without provision for the trustee's costs).

38. Practitioners should note that there is a means by which a person in the wife's position in Mekarska v Ruiz may challenge the scale of the trustee's costs (see [92A] of the judgment, which refers to Practice Statement: the Fixing and Approval of the Remuneration of Appointees (2004) [BCC] 912).

THE FMH

39. Where the bankrupt's spouse has no legal or beneficial interest in the property s/he will still have 'home rights' by virtue of s 30 of the Family Law Act 1996. These rights are a charge on the estate or interest of the bankrupt: s 31 FLA1996. But note s 336(1): home rights cannot be acquired between the issue of a bankruptcy petition and the making of a bankruptcy order.
40. Under s 336(2) of the Act these home rights will bind the Trustee in Bankruptcy who will need to make an application under s 33 of the 1996 Act to remove the spouse if s/he is in occupation. But remember that the home rights of a bankrupt's spouse persist only for as long as the marriage does.
41. Under s 337 of the Act a bankrupt who is entitled to occupy a dwelling under a beneficial estate or interest has rights against the TiB if any children under 18 have their home with the bankrupt at the time when the petition was presented. These rights arise irrespective of any home rights of the bankrupt's spouse under the FLA 1996. Although not described as home rights the rights are in exactly the same terms as those set out in s 30(2)(b) of the FLA 1996.
42. An application by the TiB to exclude the occupants under either provision must be made to the bankruptcy court: s 336(2)(b), s 337(4). On such an application the court

will make such order under section 33 of the 1996 Act 'as it thinks just and reasonable' having regard to that factors set out therein:

43. Note that under sub-s 336(5) and s 337(6) if an application is made later than a year from the making of the bankruptcy order the court must assume, unless the circumstances of the case are exceptional, that the interests of the bankrupt's creditors outweigh all other considerations.
44. If the occupying spouse cannot buy out the bankrupt's interest the TiB can sell a property in which the bankrupt's spouse has no legal or beneficial estate or interest once home rights come to an end or the court does not uphold them. If the occupying spouse does have an interest, then the TiB must apply for an order for possession and sale pursuant to s.14 TOLATA 1996.
45. Again the application must be made to the bankruptcy court which is not bound by any provision of an order made by the family court in Mesher terms whereby the sale of the home is delayed: Avis v Turner [2007] EWCA Civ 748.
46. The provisions of s 335A apply in place of those in s 15 of ToLATA. Just as with s 336 the court 'shall make such order as it thinks just and reasonable' having regard to the same list of considerations, and there is the same provision that where an application is made more than one year after the making of the bankruptcy order the court must assume that the interest of the bankrupt's creditors outweigh all other considerations unless the circumstances of the case are exceptional.
47. That the whole family will be rendered homeless is not an exceptional circumstance: Citro (a bankrupt) [1991] Ch 142.
48. In Haghighat (a Bankrupt) [2009] EWHC 649 (Ch) - sale postponed for 3 years due to the poor health of the adult son who was suffering from congenital quadriplegic cerebral palsy and epilepsy.

49. Re Bremner (a Bankrupt) [1999] 1 FLR 912 – sale deferred until 3 months after the bankrupt's death in circumstances where an eviction would have made it difficult for his wife to care for him.
50. Grant & Anr. v Baker [2016] EWHC 1782 (Ch) – Henderson J allowed the TiB's appeal against the order of a DJ that sale would be postponed for as long as the severely disabled child of the bankrupt resides at the property.
51. Prior to 2002 there were instances of bankrupts and/or their former spouses living in homes in which the TiB had an interest but in respect of which the TiB took no action. There were various reasons for this inaction, such as awaiting growth in the property market, awaiting reduction in a mortgage charged on the property. This led to great hardship for families who had assumed that they would keep their home only to be faced with eviction after many years.
52. The TiB has several options in respect of the FMH:-
- Realise his interest;
 - Apply for an order for possession;
 - Apply for an order for sale;
 - Apply for a charging order under s.31 of the Act;
 - Agree that the bankrupt will have a specific liability to the estate in consideration for which the the home will cease to be part of the bankrupt's estate.
53. If the TiB takes none of these steps then at the end of a 3 years from the date of bankruptcy the bankrupt's interest in the home will cease to be included in the bankrupt's estate and will vest in the bankrupt automatically (s.283A).
54. If the bankrupt does not tell the TiB of his interest then the period will run from 3 years of the TiB becoming aware (s.283A(5)).

55. If the TiB does not make an application for an order for sale or a charging order within the 3 year period and the application is dismissed, the interest in the home which was the subject of the application will cease automatically to be part of the bankrupt's estate and will vest in the bankrupt, unless the court orders otherwise (s.283A(4)).
56. *Mesher* or *Martin* orders can be inadvisable where there is a real risk of bankruptcy. In *Avis v Turner and another* [2007] EWCA Civ 748 it was established that where a party who has a deferred interest in a property is subsequently made bankrupt the TiB is entitled to apply for an order for sale before any of the trigger events have occurred. s. 335A applies, so after 12 months the interests of the creditors outweigh all other factors unless exceptional circumstances apply (see above).
57. Practitioners have to be mindful that the existence of a bankruptcy order may mean that the former matrimonial home is sold at a lower price, which even further diminishes the 'pot' available for division, already having been reduced by its liability for the trustee's costs. The court's considerations when facing an application to enforce a sale of the matrimonial home are different if there is a bankruptcy order in place. After one year, the interests of the creditors will outweigh all other considerations, unless the circumstances are truly exceptional (Insolvency Act 1986 s.336(5)).
58. In *Mekarska v Ruiz* what caused the trustee's costs to grow exponentially until they eclipsed the entire value of the estate was litigation between the wife and the trustee as to the sale price of the former matrimonial home. The difference in their valuations was £20,000. By contesting the sale at the lower price, the wife effectively wiped out her entire award. However, had there been no bankruptcy the wife's prospects of delaying a sale until she obtained the price she wanted would have been significantly better.

Pensions

59. A bankrupt cannot be compelled to draw pension income for the purposes of s.310(7) of the IS Act see Horton v Henry (Rev 1) [2016] EWCA Civ 989.
60. The TiB may apply to the Court under s.342A where 'excessive' contributions' to a pension arrangement have 'unfairly prejudiced' his creditors. The court will consider whether the contributions were made for the purpose of putting assets beyond the reach of any of the creditors and whether the total amount of the contributions is 'excessive in view of the individual's circumstances when those contributions were made'.. The court may make orders as it sees fit to restore the position to that which would have prevailed had the excessive contributions not been made.
61. Under s.342D pension sharing orders are capable of being transactions at an undervalue under s.339 or preferences under s.340, but only to the extent that the pension arrangement from which the PSO was carved was the result of contributions which unfairly prejudiced the transferor's creditors. If the court finds that the particular pension share could have been accommodated from that part of the transferor's pension which was not the result of excessive contributions it will not make an order which interferes with the PSO.

IVA'S

62. An IVA is an agreement individuals enter into with the assistance of an insolvency practitioner and the agreement of 75% of their creditors (by value of the debt owed). It allows individuals to repay their debts, or a proportion of them, in the comfort that, during the life of the IVA, creditors cannot apply to make them bankrupt.
63. IVA's can cause the following problems:
- i. *Reduced Assets* – on entering an IVA the debtor's assets may be transferred to the IP depending on the terms of the agreement. This means that only surplus assets after the debts have been satisfied will be returned to the debtor.

- ii. *Spouse becomes Creditor* – If the parties have an agreement (not a consent order) then the other spouse can become a creditor under the IVA, and receive only a percentage of the agreed amount.

64. Depending on the value of the assets it may be advisable to take swift action at the first sign of an IVA and get a consent order so that the client at least secures a better ranking as creditor. However, sometimes it can be better to wait until the IVA has resolved and there is the possibility of a full settlement as opposed to a creditor's percentage.

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