

THOMAS · MORE · CHAMBERS

**DEBT AND DIVORCE:  
THE CRUNCH**

**Wednesday 22<sup>nd</sup> October 2008  
6.30pm to 7.30pm**

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## **INTRODUCTION**

1. Very complex and alarm bells must sound for all family practitioners when hear of any issue of insolvency at any stage of the proceedings – see recent solicitors’ negligence case of **Burke v Chapman & Chubb** [2008] EWHC 341 in which although no causative loss proved by Claimant Wife, solicitors found to have fallen below reasonable standard of duty of care as had not considered effect of H insolvency on W.
2. Both insolvency of an individual and of a company can affect W’s finances. This paper only deal with individual insolvency. I have referred to H as the insolvent spouse in these notes and W as the “innocent” victim .....!
3. All Insolvency legislation is contained in the Insolvency Act 1986 “IA” and the Insolvency Rules 1986 “IR”. There have been frequent amendments of both IA and IR and practitioners should expect further amendments in the light of the credit crunch and proposals on reducing the number of repossessions.
4. Unsurprisingly there are numerous provisions to enable the Courts to unravel fraudulent transactions designed to avoid the effects of bankruptcy – sections 423-425 IA.
5. Sections 339-342 IA provide the court with the power to set aside transactions that have taken place up to 5 years before a bankruptcy petition has been presented.
6. Both H and W and also their lawyers need therefore to be very careful in relation to the transactions occurring between them once insolvency is in the air ....Munby J emphasised in **Whig v Whig** [2008] 1 FLR 453 that Family Division Judges should be, and are, as rigorous at applying insolvency legislation as the Chancery Division.

## **INDIVIDUAL INSOLVENCY**

7. This can take the form of:
  - (a) Individual Voluntary Arrangement “IVA”
  - (b) bankruptcy or

### **Individual Voluntary Arrangement**

8. In the alternative H may try to avoid bankruptcy or may terminate a bankruptcy by opting for an IVA.
9. The main stages of an IVA are:
  - (i) H must file an IVA proposal setting out extensive detail of his finances – clearly this a document which should be obtained in the AR
  - (ii) Proposal nominates a person to supervise IVA implementation – must be Insolvency Practitioner
  - (iii) Proposal lodged with court with report by Insolvency Practitioner stating that IVA has reasonable prospect of being approved by Creditors – 2 possible routes depending on pressure from creditors ie Insolvency Practitioner can apply for moratorium on proceedings against the debtor – s252(2) IA

- (iv) Creditors listed in proposal and any other creditors known about, vote on whether to accept IVA
- (v) H pays a % of the debts due ie the “dividend”.

10. W should obviously be given notice of the IVA creditors’ meeting if any chance of W being a creditor. Quantifiable claims are provable and W should therefore be allowed to vote. Difficulty with unquantified claims – see **Re Bradley-Hole** [1995] 1 WLR 1097 and **Re A Debtor; JP v A Debtor** [1999] BPIR 206

NB fact that W’s debt not “provable” [see below] does not mean that it is not a bankruptcy debt or that W is not entitled to vote at IVA

11. W therefore potentially can be bound by an IVA if it is approved – effect therefore on any AR. Can be unfairness on W if forced in IVA to accept an equal dividend to other creditors even though unlike other creditors W’s rights to enforce old debts survive discharge of bankruptcy [see below].

12. Obviously if W is not informed about IVA meeting and vote, can make application to bankruptcy court or H has not been truthful etc . Also possibility for bankruptcy petition to be presented by W if interests not properly represented in IVA– though see problems re provable debts below

### **Bankruptcy**

13. A bankruptcy serves to divest H of all his property, protects him from his creditors and releases him from his debts once he is discharged from his bankruptcy.

14. The main stages of a bankruptcy are:

- (i) presentation of petition – either by creditor on basis of failure to comply with statutory demand or unsatisfied execution of a judgment or by H himself on basis that cannot pay debts
- (ii) bankruptcy order
- (iii) appointment of Trustee in Bankruptcy “TIB”
- (iv) vesting of H’s assets in TIB
- (v) TIB realises H’s assets
- (vi) TIB distributes assets amongst creditors with provable debts

15. Once petition presented [ie not even the order made], all dispositions of property will be void unless approved by the court – s284(4) IA. Further, the court may stay any proceedings against the debtor – s285(2) IA.

16. W therefore must either wait for H to be discharged or must participate in the bankruptcy – any attempt to circumvent IA will be void .....

17. Bankrupt’s property – all assets belonging to H at start of bankruptcy. TIB can also claim after-acquired property up to discharge. H’s income though does not form a part of the property.

18. Bankruptcy may arise at 3 states in an AR:

- (a) before

- (b) during
- (c) after!

## **A. BANKRUPTCY BEFORE THE AR ORDER**

### **What can W do? Challenging the bankruptcy**

#### **I. Annulment of Bankruptcy Order**

19. This is the most appropriate way to defeat an improper attempt by H to defeat W's claims - **Woodley v Woodley (no. 2)** [1993] 2 FLR 477

20. Section 282(1) IA if appears to the court that:

*“the order ought not to have been made or the court is satisfied that all the bankruptcy debts and expenses of the bankrupt have been paid or secured.”*

21. **Paulin v Paulin** [2008] EWCA Civ 900 – H had filed for bankruptcy based on a large debt due to a third party Isle of Man company which was the subject of a judgment for £1.3 million in Chelmsford County Court. IoM company found to be H's alter ego, judgment totally specious and hence matters reopened ....!

22. See also **W v W** [2007] EWHC 1856 (Fam) – application to annul bankruptcy failed, and **Couvaras v Wolf** [2002] 2 FLR 107 – case transferred to Family Division and bankruptcy petition annulled.

23. **F v F (S intervening)** [2002] EWHC 2814 – H's intentions are irrelevant – only question is whether in fact on day of petition H can pay debts or not. See also **F v F** [1994] 1 FLR 359 H presented own petition to frustrate W's claims. Bankruptcy annulled. J also transferred bankruptcy proceedings to High Court so application to annul heard by same J as AR application.

#### **II. Rescission of Bankruptcy Order**

24. Commentators suggest that there is no reason why s375 IA cannot also be used in family proceedings although s282(1) would seem to be safer option. S 375 confers a general power to rescind, review or vary orders – see **Fitch v Official Receiver** [1996] 1 WLR 242

#### **III. Bankruptcy as Conduct in the MCA?**

25. **Miller v Miller** [2006] UKHL 24 set a very high bar for “conduct”. The House of Lords has made it absolutely clear that they disagreed with both HC and CA in relation to the treatment of conduct in Miller

- Lord Nicholls at paragraph 59-65
- Baroness Hale at paragraph 145-146
- Lord Mance at paragraph 161-165

26. HL has therefore confirmed that conduct should only intrude in wholly exceptional cases where the conduct is gross and obvious. See also recent case of **M v M (financial misconduct)** [2006] 2 FLR 1253 – H’s excessive gambling and lack of full disclosure justified W receiving 62.5% on basis of conduct

#### **IV. Section 37 MCA?**

27. Section 37 MCA cannot work to displace a bankruptcy as Court of Appeal has decided that any “disposition” pursuant to a bankruptcy is not act of bankrupt even if H presents own petition - **Woodley v Woodley (no. 2)** [1993] 2 FLR 477

#### **Effect of bankruptcy before any order for AR**

28. TIB not party to marriage and no order for financial provision can be made against TIB. If H will have sufficient assets such that there will be a surplus at end of bankruptcy, no reason why lump sum etc should not be ordered – see **Re G** [1996] 2 FLR 171 below.

29. The most clear risk for a wife is that in seeking to continue with the AR that she will need any disposition to be validated by the court pursuant to s284 IA as all H’s assets have now vested in the TIB.

29. It should be born in mind that in addition, transactions which have taken place before the bankruptcy are also at risk of being declared preferences or a transaction at an undervalue ie s339 and s340 IA – this could include voluntary periodical payments etc [see below].

#### **B. BANKRUPTCY DURING THE AR**

30. If W has issued AR but H presented with bankruptcy petition prior to W obtaining a final order in AR – W needs to exercise caution because of s284(1):

*“where any person is adjudged bankrupt, any disposition of property made by that person in the period to which this section applies is void except to the extent that it is or was made with the consent of the court, or is or was subsequently ratified by the court.”*

31. The period referred to is the period from the presentation of the petition onwards – s284(3) IA...Often it may take many weeks from the making of the bankruptcy order to the appointment of the TIB

#### **Disposition pursuant to s284 IA**

32. It is important for family lawyers to understand what a “disposition” is pursuant to s284 IA as once a bankruptcy petition has been presented, all subsequent dispositions are void. The Court of Appeal has made it clear in **Mounteney v Treharne** [2002] EWCA Civ 1174 that in the case of a property adjustment order, the disposition is made as the time of the order once the Decree Absolute has been made, and not of its execution. The property adjustment order was therefore not void pursuant to s284 IA.

33. To the extent that the disposition has occurred after the petition has been presented W may apply to the court for its ratification – see **Forrester** [2003] EWHC 2784 (Ch) in

which the legal costs of W trying to find H's assets were "ratified" in that W was allowed to have property adjustment orders up to the value of the costs.

### **Ratification under s284**

34. The difficulty in trying to come to an agreement after presentation of the petition but before any order is made is that W will not know whether or not the court will or will not make an order for bankruptcy. Once an order has been made it is then highly unlikely that the court would ratify any "disposition" that placed W at an advantage vis a vis other creditors.

### **C. BANKRUPTCY AFTER THE AR ORDER**

35. Once H is bankrupt, W has 3 options in relation to seeking to enforce any financial orders she has obtained:

- (i) W can become a creditor in the bankruptcy to the extent that she has a provable debt;
- (ii) W can seek to enforce the order as against H's income, to the extent that he has any and to the extent that H's income is not already eaten up by an Income Payment Order directing monies to the TIB
- (iii) W can wait until if and when H is discharged from the bankruptcy to see if matters have improved ...

### **W as a Creditor with a provable debt**

36. The Insolvency Rules 1986 set out what types of debts are "provable" in a bankruptcy ie which claims by creditors are debts which can be taken into account by the TIB

37. When first drafted IR 12.3 stated under "Provable debts" that

*"The following are not provable in bankruptcy...any obligation arising under an order made in family proceedings"*

38. In 1993, IR 12.3 was amended to make CSA assessments also NOT provable debts. In April 2005 IR 12.3 was further amended to make "lump sum or costs orders" in family proceedings at last provable.

39. This is extremely important as, leaving H's income to one side, being a creditor in the bankruptcy may be W's only real hope

40. One wonders whether this IR will be further amended to include spousal maintenance and court ordered maintenance.....

41. Bear in mind that the situation with a separation deed or agreement will be different in that even maintenance arrears will be provable debts [although there may be an issue of setting aside the transaction .... see below]. However, in any event s329 IA provides that a creditor who is a spouse at the commencement of the bankruptcy will have their debts ranked after all of the other creditors .....

42. It should be born in mind that unless a debt is provable, it cannot form the basis of a bankruptcy petition as it would be pointless as the petitioner would have no legitimate financial interest in the bankruptcy process.

43. In **Levy v Legal Services Commission** [2001] 1 All ER 895 H had been ordered to pay costs of his legally aided W in their AR. H did not pay W's costs and LSC sought to bankrupt H by presenting a statutory demand and then a bankruptcy petition NB this was before costs orders became provable debts. The Court of Appeal was clear that whilst creditor with a non-provable debt could present a bankruptcy petition, the Court could not envisage circumstances in which a bankruptcy order would be made - **Russell v Russell** [1999] 2 FCR disproved

44. To the extent that the debt W has is not a provable debt, IA provides that W may in fact enforce during the bankruptcy – such application, however, is unlikely to succeed – for example any attempt to issue a judgment summons is unlikely to be paid, save from H's income [see below]. Attempts to commit H to prison in default of condition to pay cannot succeed as IA s305 is a defence as all assets vest in TIB etc etc

### **W seeking to enforce an order against H's income**

45. A bankrupt's income is still his own – subject to any application by the TIB can make application for income payments order under s310 IA. This means that W can seek to enforce any orders against that income. However, the likelihood is that if H has an income considerably in excess of his own basic needs, that the TIB will seek an income payments order.

46. It is therefore recommended that whether the bankruptcy order is before, during or after the AR that a maintenance order is obtained before any income payments order is made as it may set a level below which the bankruptcy court does not wish to venture ...

47. The issue therefore arises as to the factors which the Insolvency Courts take into account when ordering an income payments order which must in any event leave H with:  
“*what is necessary for meeting the reasonable domestic needs of the bankrupt and his family*” IA s 310(2)

48. Section 385 IA 1986 defines a “family” restrictively meaning the persons if any who are living with the bankrupt and are dependent upon him.

49. In **Re G** [1996] 2 FLR 171 Mr Justice Singer stated in relation to an application for a lump sum under Schedule 1 Children Act 1989 that he would make an order even though H had just been adjudged bankrupt. The Judge stated that this was on the basis that he had the jurisdiction to do so and that there was a possibility that W would receive some payment out of H's income or that there could be enforcement once the bankruptcy had been discharged. Singer J suggested albeit *obiter* that were the TIB to apply for an income payment order that any order under the CA Schedule 1 [whether income or a lump sum] would be taken into account in the exercise of the court's discretion in the same way that as a matter of practice CSA assessments were taken into account.

50. See also **Albert v Albert** [1996] BPIR 232. In **Re Rayatt** [1998] 2 FLR 264 an income payments order was discharged to allow the children of the family to remain in private education. **Scott v Davis** [2003] BPIR 1009 also considered the issue of private school fees.

### **W waiting for H's discharge**

51. IA s281(5) (b) ensures that although H may be discharged, W retains right to enforce matrimonial debts and CSA [even though not provable debts] notwithstanding statutory release of H from bankruptcy debts.

52. See for example the case of **Pearce v Pearce** (1980) FLR 261 in which an application for a lump sum order made at the time of the divorce was reactivated after discharge

53. It should be borne in mind that H could apply for a release from any family financial order under s 281(5)(b).....

### **LOOKING OVER YOUR SHOULDER - ATTACKING TRANSACTIONS AFTER THE EVENT**

54. Lawyers need to be particularly concerned in relation to settlements made before a bankruptcy petition is presented. Sections 339 and 340 IA provide as follows:

Section 339(1) “...where an individual is adjudged bankrupt and he has at a relevant time (defined at section 341) entered into a transaction at an undervalue, the trustee of the bankrupt’s estate may apply to the court for an order under this section.”

Section 340(1) “...where an individual is adjudged bankrupt and he has at a relevant time (defined in section 341) given a preference to any person, the trustee of the bankrupt’s estate may apply to the court for an order under this section ..”

55. Section 341(1) states:

“(a) in the case of a transaction at an undervalue, at a time in the period of 5 years ending with the day of the presentation of the bankruptcy petition on which the individual is adjudged bankrupt.

(b) in the case of a preference which is not a transaction at an undervalue and is given to a person who is an associate of the individual (otherwise than by reason only of his being an employee) at a time in the period of 2 years ending with that day, and

(c) in any other case of a preference which is not a transaction at an undervalue, at a time in the period of 6 months ending with that day.”

Section 342 also provides for the recoupment of excessive pension contributions.

56. See **Re Jones (A Bankrupt)** [2008] BPIR 1051 in relation to a consent order made prior to a bankruptcy.

57. In relation to contested proceedings, recent caselaw has made matters much simpler. **Hill v Haines** [2007] EWCA Civ 1284 makes it clear that a contested AR is safe from being opened up at a later date by the TIB in later bankruptcy proceedings, save for fraud, misrepresentation or mistake. In this case the parties had a contested hearing in 2003 resulting in W receiving a property adjustment order. H was made bankrupt in 2005 and the

TIB sought to re-open the AR pursuant to s339 IA. The Court of Appeal made it clear that there was in reality no room to review a court's decision in adversarial proceedings.

## **PRACTICALITIES**

58. In relation to disclosure, W should seek:

- (a) The bankruptcy petition
- (b) The Statement of Affairs H must file if it is his own petition – obviously useful for any application to annul

In addition W may need an inspection appointment to compel production of documents from TIB as all H's documents, including those of H's solicitors in AR now vest in TIB.

59. Important therefore that impact of all W-H correspondence is considered vis a vis TIB seeing documents – eg has W admitted that she knew H insolvent?

60. Declaration of Solvency – some commentators consider that fact that sought is an indication of W's suspicion .....!

61. Bankruptcy Search can be carried out on the Register of Bankruptcy Orders held by Insolvency Service or in person at Bankruptcy Court.

IVA search can also be carried out by contacting Insolvency Service in Birmingham

NB it may be important to carry out further searches immediately before any transfer is made

62. W should not be afraid to negotiate directly with the TIB – there is nothing in principle wrong with this!

## **HOUSE**

### **USEFUL SOURCES OF INFORMATION**

Debt and Insolvency on Family Breakdown - Schofield and Middleton [2<sup>nd</sup> Edition 2003]  
Family Law

The Family, Creditors and Insolvency – [2004] Gareth Miller OUP

Rayden & Jackson Family Law 18<sup>th</sup> Edition – Chapter 19

Personal Insolvency, Law and Practice – Schaw Miller

[www.insolvency.gov.uk](http://www.insolvency.gov.uk)

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