

38. English Personal Insolvency

Bankruptcy

Bankruptcy is the legal procedure for dealing with personal insolvency. Bankruptcy collects the assets of the insolvent debtor and distributes them amongst his creditors proportionately. It also has the effect of protecting a debtor from legal enforcement by his creditors. Bankruptcy is the equivalent of liquidation of an insolvent company and many of the rules are similar.

Bankruptcy legislation in England has been radically reformed in the last 25 years and is now significantly different to Irish Bankruptcy law. The vast majority of debts do not survive bankruptcy. Discharge means that the debtor can proceed to have legal capacity and can commence to trade and contract debts again. This is in contrast to the Irish position whereby there is generally no discharge for at least 12 years.

A key aspect of bankruptcy is that all debtor's assets vest (i.e. are transferred) to an official who administers the bankrupt's assets. The creditors get paid proportionately and are accordingly treated equally. However, secured creditors and so

called preferential creditors have priority in entitlement to payment of the proceeds of realisation of the bankrupt's assets.

He is subject to certain restrictions and disabilities on trading and in obtaining credit for a period. In bankruptcy, as in liquidation, the trustee in bankruptcy can challenge pre-bankruptcy transactions if they appear to be at an undervalue or if constitute a preference to a particular creditor.

IVAs

There are a number of alternative procedures by which a debtor may avoid bankruptcy which are more flexible and more attractive than the equivalent options available in Ireland. There is a simplified debt relief procedure for smaller non-trade debts. As in Ireland, there is the possibility of a Deeds of Arrangement. This will not generally be an attractive option, because it only works with the agreement of all creditors.

The most important alternative to bankruptcy is the Individual Voluntary Arrangement (so called "IVA"). It enables relief against debts without resort to bankruptcy. An IVA is an agreement between a debtor and his creditors that is legally binding and enables the insolvent debtor to secure release from his debts.

Once the arrangement is agreed with at least 75% in value of creditors, the creditors' claims will be settled in accordance with the terms of the arrangement and not the prior debt. Creditors may decide that the IVA offers a better, more realistic prospect of a return than is the case with bankruptcy.

Other Enforcement Stopped

Once a petition for bankruptcy is presented, all legal proceedings and enforcement of legal orders against the assets and person of the debtor are stopped. A creditor cannot retain the benefit of the enforcement of a Court Order unless it was completed before bankruptcy commenced. Once the sheriff is notified of a making of a Bankruptcy Order, he must deliver up goods, money seized and recovered in satisfaction to the Official Receiver. The Sheriff's costs are a first charge on the goods.

There are limitations on a landlord seizing goods in satisfaction of rent during a bankruptcy. A landlord is limited to six months' rent accrued prior to the bankruptcy order. A landlord can enforce after the order in relation to new arrears, without restriction.

There are limited exceptions, where action can be taken with the permission of the Court. Secured creditors may still proceed

against their security e.g. mortgaged property. Legal proceedings against the bankrupt are stayed and cannot be prosecuted after the making of the bankruptcy order without Court approval.

Procedure

Bankruptcy commences by a court making a bankruptcy order. A petition is an application to Court for a bankruptcy order and may be made by a creditor, the debtor himself or by a supervisor of a voluntary arrangement.

The application (or "petition") for a bankruptcy order, can be based on a statutory demand or on an unsatisfied judgement. The statutory demand must be for at least £750, must be due and must not be disputed. The debtor must not have a counterclaim against it.

The petition is an application to the Court which complies with certain requirements in the insolvency rules. Particulars of the debtor's name, address, occupation, business, details of the debt and the grounds for the petition must be set out.

The petition will generally be made to the County Court. In certain situations including where the petitioner is not resident in England or Wales, it must be presented to

the High Court. The petition must be served (i.e. delivered) on the debtor personally. When an application for bankruptcy is made to the Court, it is registered in the Register of Pending Actions.

On the hearing of a petition for bankruptcy, the Court has a number of options. It may dismiss the petition if it is satisfied the debtor is able to pay its debts and the creditor has unreasonably refused debtor's offers to secure or compromise. It may adjourn or stay the petition. It may make a bankruptcy order.

There are limited grounds for resisting a petition for bankruptcy. One option may be to pay the debt or offer to settle it in some way. Another may be to oppose the petition on the grounds that the debt is not properly due or that there are other appropriate defences or grounds for dispute. A further alternative is an application for an interim order to facilitate a Individual Voluntary Arrangement (IVA).

Debtor's petition

The debtor himself can make a petition for bankruptcy, based on his inability to pay debts. He will request that the bankruptcy order be made. The purpose is to protect the bankrupt from his creditors. The debtor

must file the petition and his statement of affairs with the Court together with an affidavit verifying this statement.

A bankruptcy order will require the bankrupt to attend the Official Receiver immediately and will also stop any pending legal proceedings against the bankrupt. The Court sends copies of the bankruptcy order to the Official Receiver. The Official Receiver sends one copy to the bankrupt.

The Official Receiver sends notice of the making of the order to the Chief Land Register. This is registered in the register of writs and orders affecting land. The Official Receiver advertises the order in the Official Gazette and in such newspapers as it thinks fits. The Order will require the bankrupt to attend before the Official Receiver.

Bankruptcy Order

Once a bankruptcy order is made by the Court, the bankrupt person becomes subject to the legal restrictions and consequences that arise from bankruptcy. The Enterprise Act which was introduced in 2002, was designed to remove some of the stigma and disadvantages of bankruptcy.

The Official Receiver (which is a Government official) takes control of the

Bankrupt's affairs and control of debtor's assets pass to him. The ownership of the bankrupt's assets are taken away and transferred to the OR for the purpose of distribution to creditors. Under certain circumstances, the Court may appoint a "private" Insolvency Practitioner to act instead of the Official Receiver.

Legal proceedings may only be commenced with court consent. Existing proceedings are suspended. Execution and enforcement of judgements completed after commencement is void.

Duties of Bankrupt

On the making of the bankruptcy order, all transfers of property and assets by the debtor are void, Third parties receiving payments from the bankrupt must hold them as part of the bankrupt's estate. They are treated as creditors. Innocent third parties recovering payment before commencement of bankruptcy or through third parties, without knowledge of the bankruptcy are protected.

The bankrupt person has a number of duties and obligations. He must not obtain credit in excess of £500.00 without disclosing his bankrupt status. He may only trade in the bankruptcy name. He may be precluded

from certain professions including solicitors, etc. A partnership in which a bankrupt was a member will automatically dissolve. The bankrupt is disqualified as a company director.

The bankrupt must co-operate with the Court and attend meetings. He must attend public or private examination, if required. The bankrupt must deliver up all books, papers and assets to the Official Receiver. He must give an account of his assets. He must deliver possession of his assets to the Official Receiver. He must attend the Official Receiver as required. He must provide accounts for the previous three years if he had a business. He must notify the Official Receiver within 21 days of acquiring property after bankruptcy and of increases in income.

A Statement of Affairs must be filed within 21 days of bankruptcy. The statement must be in a prescribed form and must set out the secured creditors, unsecured creditors and an inventory of assets. It must be verified by a sworn affidavit. Copies must be delivered to the Official Receiver. The Official Receiver may demand further written particulars in order to expand or update the Statement of Affairs.

The Official Receiver may apply to Court for a public examination of the bankrupt. A

public examination must be applied for, if more than half of the creditors require. The examination is under oath. The Official Receiver and creditors may ask questions either directly or through their lawyers. A record of the hearing is kept, which the bankrupt must sign and verify. It is not admissible against him in a criminal prosecution.

The OR may apply to Court for a private examination of the bankrupt, the bankrupt's spouse or former spouse, persons believed to have property comprised in the bankrupt's estate, the bankrupt's debtors or any persons appearing to have information which is relevant to the bankrupt's dealings or affairs.

The Court may require persons possessing the bankrupt's property or having relevant information to submit affidavits of their dealings and knowledge of the bankrupt and / or to produce documents in their control. The Court may issue a warrant for arrest of any person summoned or for the service of books, papers, records in that person's possession.

Bankrupt's estate

A bankrupt's "estate" refers to all of his assets at the time of commencement of bankruptcy. This includes all his assets,

future or present, whatsoever. A bankrupt's estate vests in the bankruptcy trustee immediately on his appointment. These assets are available to the creditors for distribution.

The following assets only are excluded from bankrupt's estate which vest in the trustees:-

- ❖ tools;
- ❖ books;
- ❖ vehicles;
- ❖ equipment necessary for use personally in employment, trade or vocation;
- ❖ clothing, bedding, furniture, household equipment and provisions as are necessary for satisfying basic domestic needs of the bankrupt and his family;
- ❖ property held by the bankrupt on trust for others;
- ❖ income for reasonable domestic needs;
- ❖ after acquired property;
- ❖ certain pension schemes.

As with liquidations, the OR and trustees in bankruptcy have power to bring assets back into the estate which would otherwise be excluded. Where they believe that the value of household effects is high, the trustee can claw back such items where realisation would benefit the creditors.

Income

A bankrupt's income does not form part of the estate available to creditors. However, the OR or trustee in bankruptcy can apply to Court for an order that the part of the income be paid over for the benefit of creditors. In practice, the OR / trustee will only apply if they are unable to negotiate a figure with the bankrupt. Any Court order that is made must leave the bankrupt with sufficient income to meet his basic domestic needs and those of his family. The Court can vary or discharge the order, upon the application of the trustee or the bankrupt.

The income payment agreement procedure (IPA) is designed to reduce the need for Court involvement in non-contentious cases. An IPA is a written agreement between the bankrupt and the OR/ trustee by which a bankrupt voluntarily agrees to pay a sum to the estate for a specified period. The bankrupt or his trustee can vary the IPA on application to Court.

Prior to 2002, an IPA generally ceased upon discharge of the bankrupt. Because of the reduced period of discharge to 12 months, the IPA is now for a maximum period of three years from the making of the order. Therefore, payments may have to be made under it, notwithstanding discharge from bankruptcy.

Where a bankruptcy order is made, rights under an approved pension arrangement are excluded. This covers both personal and occupational pension schemes. The OR / trustee is entitled to apply for income payments to be made in respect of any pension payments made to the bankrupt. He can also apply to Court for an order that contributions previously made by the bankrupt into his pension be paid back to creditors. The Court may order the pension payments to be restored.

The OR / trustee is entitled to disclaim so called onerous property. "Onerous" property is any enforceable contract or other property in an estate which is unsaleable and not realisable, which may give rise to a liability to pay or perform obligations. The typical example is a commercial lease.

Setting Aside Pre-Bankruptcy Transactions

A trustee has power to unwind certain earlier transactions by the bankrupt in order to recover assets for the estate.

A pre-bankruptcy transaction at an undervalue can be set aside. An undervalue transaction includes a gift or a transaction at an undervalue within five years prior to the bankruptcy petition. Where the transaction is between two to five years from the petition

date then it must be shown that the individual was insolvent at the time. Insolvency does not need to be shown if the transaction was in the last two years. Insolvency is presumed where the recipient is an associate of the bankrupt.

A preference is given by a bankrupt to a creditor if he does anything which has the effect of putting that person into a position which, in the event of a bankruptcy, would be better than the position that he would have been in if the thing had not been done. This can include granting security over assets.

An application can be made to Court to set aside a preference. The Court may make an order in respect of a preference if it is shown that there is a desire to produce a preference for the benefit of the person concerned. The debtor must have been insolvent at the time. The desire is presumed where the preference is given to an associate.

A transaction is extortionate if the terms are such as to require grossly exorbitant payments to be made in respect of the provision of credit or otherwise offends against the ordinary principles of fair dealing. If a person is adjudged bankrupt and has been party to an extortionate transaction, the Court may, make an order in

relation to an extortionate transaction which took place in three years prior to commencement to bankruptcy.

An order may provide for setting aside any obligation created by the transaction, varying the terms of the transaction, requiring any person who is party to the transaction to repay sum requiring the party who surrenders security or requiring an account to be taken.

Trustee and Creditors' Committee

Upon the making of a bankruptcy order the Official Receiver is appointed to take control of the bankruptcy assets or affairs. The Official Receiver is a public official. A trustee may be a private insolvency practitioner.

The Official Receiver's main function is to protect the assets the estate of the bankrupt. He must take all steps to protect the assets. He must decide as soon as possible within 12 weeks whether to call a meeting of creditors. He must investigate the conduct and affairs of the bankrupt unless he thinks an investigation is unnecessary. He has the discretion to report to the Court in the outcome investigation.

As soon as practicable within 12 weeks from the date of Bankruptcy Order, the Official

Receiver must decide whether to call a meeting of creditors. The function is to appoint a trustee in place of the OR and /or establish a creditors committee. If the OR decides not to call a meeting he must give notice of his decision to the Court and to all creditors known to him. The OR becomes trustee from the date of this notice.

Meeting of Creditors

The Official Receiver / trustee may convene meetings for the purpose of ascertaining the wishes of the creditors in relation to the bankruptcy. Creditors may requisition a meeting by making a request.

Twenty one days notice must be given of meeting to creditors appearing in the Statement of Affairs. A notice must state the purpose of a meeting, the time and place and include a proxy. Trustees may give notice by advertisement if they see fit. This will depend on the cost of the advertisement, interest of creditors and funds available in the estate.

Creditors are entitled to vote provided they have lodged proof of their debt by the deadline and their proof has been admitted. Liquidated or unascertained debts will only be permitted if the chairman agrees an estimated minimum value. Secured creditors

can only vote in respect of unsecured elements of the debt.

A final meeting of creditors must be called to receive the trustee's report and to release the trustee. The trustee gives 28 days notice of a meeting to all creditors who have proved their debt in the bankruptcy. He lays a report before the meeting which includes a summary receipt of payments and a statement that he has reconciled his accounts with the insolvency service account.

The creditors may question the trustee with regard to any matter in his report. They can resolve against him being released. A trustee gives notice to the Court that a final meeting has been held and send a copy of his report. A copy of the notice is sent by the Trustee to the official receiver.

Creditor's committee

A creditor's committee with between 3 and 5 members may be established at the first or subsequent meeting of the creditors. If no committee is appointed, its function vests in the Secretary of State (a Government Body).

Creditors who have proved their debt or lodged the proof may sit on the committee.

There are designated procedures in relation to the operation of the committee.

The Trustee must report to the committee unless there are no assets or the cost of compliance will be too great having regard to the importance of the matter. The committees' consent is required to the trustee appointing the bankrupt to manage his estate, carry out business on the creditors' behalf, or assist in the administration.

Family / Matrimonial Home in bankruptcy

Bankruptcy will "sever" a joint tenancy. This means that the interest of a husband or wife will be separately owned from then onwards. Where a family home is in the bankrupt's name only and the other spouse cannot show a beneficial share by way of contribution, then the entire value will be available to the bankrupt's creditors.

When a property is in two names, the beneficial ownership of each party will depend on property law principles. This will generally depend on what contributions may have been made by each party. There may have been an intention, written, implied or verbal that the equity be owned 50/50. This will be commonly the case with spouse.

Where a property is in the sole name of the bankrupt, the non-owning spouse may be able to claim an entitlement to part ownership by virtue of contributions made to the purchase or repayment of a mortgage. Correspondingly if a property is in the name of a non-owning spouse, the trustee may be able to claim a share as being entitled to a share.

A bankruptcy trustee has a number of options to realise the equity in the property to which the bankrupt is entitled. The trustee could approach the non-bankrupt spouse with a view to that spouse buying out the bankrupt's share. The non-bankrupt spouse could agree to put the property up for sale in the open market so that the bankrupt's and the spouse's respective shares are divided.

If the bankrupt's spouse cannot or will not co-operate, the trustees could apply for a Court Order for sale. The Court may make such order it thinks just and reasonable having regard to the interests of the bankrupt's creditors, the conduct of the spouse or former spouse in contributing to the bankruptcy, the needs and resources of the spouse, the needs of the children and all the circumstances of the case. The bankrupt's interests are not considered.

There are certain rights of occupation which may (though not necessarily) impede an order for possession. The non-bankrupt spouse may have a statutory right of occupation irrespective of ownership or shares. This right arises under legislation. The spouse has a right of occupation where he has a beneficial interest in the property and a person under 18 has his or her home there.

If either of these situations apply, then after a period of one year it is deemed that the interests of the bankrupt's creditors outweigh other consideration, unless the circumstances are exceptional. This is likely to postpone sale for at least a year.

The Courts will not generally refuse sale except in circumstances where there is a prospect of repayment or if considerable hardship would be caused, e.g. persons suffering from illness, unwell, elderly person reside in the property. If the Court refuses an Order and the Court application is dismissed, the property will vest back in the bankrupt unless the Court orders otherwise. The proceedings will often therefore be adjourned by trustees.

If the property cannot be sold, the trustees can apply for a charging order. Trustees have the power to apply for a charging order where they are unable to sell or realise a

share in the dwelling house occupied by a bankrupt's spouse or former spouse. The effect of the charging order is that the benefit of the charge is available for the creditors but that the property ceases to become comprised in the estate and re-vests in the bankrupt. The effect is that the trustee has lost control of how and when the property is sold.

A trustee cannot call a final meeting to be released from his obligations if he has been unable to realise an interest in the dwelling house, unless he has applied to Court for a charging order. If a charging order is an unsuitable option, a trustee may apply to the Secretary for State for a certification that it is inappropriate or inexpedient to apply. It may be inappropriate where there are no funds to make the application or the creditors or unwilling to fund further litigation.

Where a property in a bankrupt's estate consists of a share in a dwelling house which is the residence of the bankrupt spouse or former spouse, then at the end of three years from the date of bankruptcy, the house will re-vest in the bankrupt and will no longer form part of the assets available for creditors. This prevents trustees sitting on the value of house waiting for the value to rise and later applying for repossession. The trustees must within 3 years sell or realise the interest in the property or apply for an

order for sale or possession or apply for a charge or enter into an agreement

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This is an extract from our "Legal Guide to the Management and Enforcement of Security in England and Wales for Irish Lenders (2009). The Guide is intended as an overview and broad outline of the matters covered in it. Its purpose is to inform and raise awareness. We are happy to offer specific legal advice on particular circumstances. It should not be relied on as a substitute for comprehensive legal advice with reference to the particular circumstances. While we have taken due care in the preparation of this publication, we do not accept legal liability as a result of any reliance placed on anything in it. The reader should rely only on specific legal or taxation advice. This extract is based on the law as of 1st August 2009.

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CONTACTS

Paul McMahon

pmcmahon@lavellecoleman.ie

Phone: (353) 1 6445800

Fax: (353) 1 6614581

Lavelle Coleman
Solicitors
20 On Hatch
Lower Hatch Street
Dublin 2
Ireland

www.lavellecoleman.ie

LAVELLE COLEMAN

Lavelle Coleman Solicitors

20 On Hatch, Lower Hatch Street,
Dublin 2, Ireland.

t +353 1 644 5800

f +353 1 661 4581

ds 109010 Fitzwilliam

e law@lavellecoleman.ie

w www.lavellecoleman.ie