

## ENGLISH BANKRUPTCY PROCEDURE GUIDE

A bankruptcy is deemed to commence on the date of the bankruptcy order.

The advantages of a bankruptcy to a debtor are:

- Σ automatic discharge after 1 year;
- Σ vast majority of debts will not survive bankruptcy; and
- Σ bankrupt will have no further contact with the creditors, which should lead to less stress.

The disadvantages of a bankruptcy to a debtor are:

- Σ all assets vest in the trustee, so the debtor loses control of his assets (including the matrimonial home);
- Σ the debtor cannot be a director or hold certain professional appointments such as a solicitor or accountant;
- Σ the debtor becomes subject to the disabilities (e.g. restrictions on trading and obtaining credit), obligations and stigma that arise in bankruptcy. This may make it difficult for a debtor to continue to trade;
- Σ potential liability for bankruptcy offences; and
- Σ the trustee can challenge the validity of transactions if they appear to have been at an undervalue or a preference.

The grounds of a creditor's petition will be the debtor's inability to pay his debts. The creditor must be able to prove to the court that the debtor is unable to pay his debts or has no reasonable prospect of paying them. This will be shown by:

- Σ statutory demand;
- Σ unsatisfied judgment execution; or
- Σ judgment followed by statutory demand.

### Consequences of a bankruptcy order being made

The Official Receiver ("OR") is appointed as the receiver and manager of the bankrupt's estate.

- Σ control of the debtor's estate passes to the OR;
- Σ on the making of the order post-petition dispositions by the debtor of his property are void;
- Σ legal proceedings may only be commenced against the debtor with leave from the court and existing proceedings can be stayed;
- Σ execution completed post-commencement is void;
- Σ the landlord may only levy distress post-bankruptcy order in relation to pre-bankruptcy order arrears. This is further restricted to 6 months rent accrued pre-bankruptcy;
- Σ the bankrupt owes a number of duties to the OR;

- Σ the debtor must not obtain credit in excess of £500 without disclosing bankruptcy status;
- Σ the bankrupt may only trade in the bankruptcy name or he must disclose the name in which he was adjudged bankrupt;
- Σ the bankrupt may be precluded from certain professional appointments i.e. solicitor, accountant;
- Σ partnerships are automatically dissolved;
- Σ disqualification as a director (under Section 11 CDDA 1986); and
- Σ the bankrupt has a duty to co-operate with the court and must attend creditors meetings if required.

#### Duties owed by the debtor to the OR

The debtor must:

- Σ deliver up to the OR all books, papers and other records of which he has possession or control;
- Σ give to the OR an inventory of the estate;
- Σ deliver possession of the estate to the OR;
- Σ attend on the OR as the OR shall reasonable require;
- Σ provide accounts for the previous 3 years (when involved in running a business);
- Σ provide a statement of affairs within 21 days; and
- Σ notify the OR within 21 days of property acquired by him after the commencement of bankruptcy or any increases in income.

#### Bankruptcy offences

There are a number of bankruptcy offences that can be committed by the bankrupt (some of them retrospective). These include:

- Σ non-disclosure of property/failure to inform of a disposal which might be set aside;
- Σ concealment of property;
- Σ failure to deliver up books, papers and other records; or
- Σ if bankrupt makes any false statement.

#### Role and function of the OR

The OR's main role is to protect the estate. He has the same powers as a receiver or manager appointed by the High Court plus the power to dispose of goods which are perishable or likely to diminish in value. The OR will take all steps he thinks fit for protecting the estate and as soon as practicable in the period of 12 weeks from the date of the bankruptcy order will decide whether to call a meeting of the creditors. He will also investigate the contacts and affairs of the bankrupt unless he thinks an investigation is unnecessary.

The function of the first meeting of creditors is to appoint a trustee and to establish a creditor's 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 or appearing in the bankrupt's statement of affairs. The OR will become trustee from the date of this notice.

At the first meeting with creditors, a number of resolutions will be taken, including, a resolution to appoint a named insolvency practitioner to be trustee in bankruptcy or two or more named insolvency practitioners as joint trustees.

### The estate

A bankrupt's estate comprises all property belonging to or vested in the bankrupt as at the commencement of bankruptcy i.e. date of the order. The bankrupt's estate vests in the trustee immediately upon his appointment taking effect, or in the case of the OR, on his becoming trustee.

The following assets do not form part of the bankrupt's estate:

- Σ such tools, books, vehicles and other items of equipment as are necessary to the bankrupt for use personally by him in his employment, business or vocation;
- Σ such clothing, bedding, furniture, household equipment and provisions as are necessary for satisfying the basic domestic needs of the bankrupt and his family;
- Σ property held by the bankrupt on trust for any other person;
- Σ income for reasonable domestic needs;
- Σ after acquired property;
- Σ matters subject to a forfeiture clause (for example, a commercial lease usually provides for forfeiture and re-entry on non-payment of rent or on bankruptcy);
- Σ peerages and titles of honour;
- Σ liens on books, papers or records of the bankrupt are unenforceable to the extent they would deny possession to the trustee; and
- Σ rights under an approved pension scheme if the petition is presented after 29<sup>th</sup> May 2000.

Note that the trustee can disclaim onerous property (any unprofitable contract or any other property comprising the debtor's estate which is unsaleable, or not readily saleable, or such that it may give rise to a liability to pay money or perform any onerous act) even if he has taken possession of the property, endeavoured to sell the property or exercised rights of ownership in relation to it. However, the trustee cannot disclaim except with the leave of court in relation to after acquired property and household effects exceeding reasonable replacement value. A disclaimer determines from the date of filing at court the rights, interest and liabilities of the bankrupt and his estate in respect of the disclaimed property. It also discharges the trustee from all personal liability in respect of property disclaimed as from appointment as trustee.

### Antecedent transactions

The trustee has the power to take action to recover assets for the estate in respect of:

- Σ transactions at an undervalue;
- Σ preferences;
- Σ extortionate credit transactions;
- Σ post petition dispositions; and
- Σ excessive pension contributions.

### Matrimonial home

In most bankruptcies the most significant asset is likely to be the bankrupt's home. In dealing with the matrimonial home the trustee will need to consider the following points:

- Σ what equity is available;
- Σ how much of the equity vests in the trustee;
- Σ whether the share of the equity has been affected by equitable accounting/exoneration;
- Σ how the trustee can realise the property; and
- Σ what steps should be taken if the equity can not be realised.

The trustee has a number of options to realise the equity available.

Without court proceedings - the trustee will approach the non-bankrupt spouse (assuming there is one) with a view to buying out the bankrupt's share of the equity. Or the trustee may come to an agreement with the debtor whereby the debtor incurs a specified liability to the estate in consideration for which the interest in the property would cease to form part of the estate.

Order for possession and sale - if the non-bankrupt spouse cannot or will not co-operate the trustee will apply to the court for an order of sale. On such an application, the court will make such an order as it thinks just and reasonable having regard to interest of the bankrupt's creditors, conduct of spouse/former spouse as contributing to the bankruptcy and needs and resources of the spouse/former spouse, need of any children and all circumstances of the case (but not the bankrupt's interest).

Rights of occupation - the non-bankrupt spouse has a right of occupation and the bankrupt has a right of occupation where he has a beneficial interest in the property and any persons under 18 live at the home (at the time of presentation of petition) with the bankrupt. After a period of 1 year from the date of appointment of the trustee the court shall assume that the interests of the bankrupt creditors outweigh all other considerations unless the circumstances of the case are very exceptional.

Charging order - the trustee has the power to apply to court for the imposition of a charge where he is unable to realise an interest in a dwelling house occupied by the bankrupt, spouse or former spouse. The effect of a charging order is that the benefit of the charge is comprised in the bankrupt's estate (i.e. vested in the trustee) and the property ceases to be comprised in the estate and re-vested in the bankrupt. A restriction will be placed against the title number (if the land is registered) of the property. The practical effect is that the trustee has now lost control of how and when the property will be sold.

If the matrimonial home is held in joint names the legal estate does not vest in the trustee but he is able to deal with the bankrupt's beneficial interest.

### Three year rule

Where property in the estate consists of an interest in a dwelling house which at the date of the bankruptcy was the sole or principal residence of the bankrupt or the bankrupt's spouse (or former spouse), at the end of three years from the date of the bankruptcy, the house will re-vest in the bankrupt and will therefore no longer form part of the estate.

The rule was introduced to prevent trustees from taking no decisive action in relation to the property, waiting for the value of the house to rise and then many years later applying for repossession.

To prevent the rule applying the trustee must within three years:

- Σ release the interest in the property; or
- Σ apply for an order for sale or possession; or

- Σ apply for a charging order; or
- Σ enter into agreement with the bankrupt whereby the bankrupt gets the property back in return for a promise to pay money to the estate in the future.

### Investigative powers

The trustee has a number of powers to obtain information regarding the bankrupt's estate, including the power to summon meetings of creditors, public and private examination, seizure of the bankrupt's property and power to demand protection of documents by Revenue & Customs.

The trustee also has a number of powers for getting in assets in the bankrupt's estate, including private examination, power of arrest, seizure of the bankrupt's property, power to redeem assets subject to security and power to demand delivery of estate, books, papers and records.

### Discharge

Discharge will be automatic from one year from the date of the bankruptcy order. However, discharge can be more than one year from order if either the OR or the trustee applied to the court for time to cease to run on the basis that the bankrupt is not complying with his obligations. Discharge can occur in less than one year if the OR files notice in court to the effect that an investigation is unnecessary or concluded.

On discharge the bankrupt will be released from all bankruptcy debts and interest thereon. There are some debts which the bankrupt will not be released from. These are:-

- Σ secured debts;
- Σ debts arising from fraud or fraudulent breach of trust;
- Σ fines;
- Σ lump sum orders and costs awarded in family proceedings;
- Σ damages for personal injury awarded in tort or contracts; and
- Σ student loans.

Note that some debts are not provable and hence the bankrupt will not be released from them. For example, drug confiscation orders and obligations arising under a periodic payments order made in family or domestic proceedings.

The estate will not re-vest in the bankrupt. Assets not yet realised and distributed remain vested in the trustee. The powers and duties of the trustee in relation to the estate are unaffected by discharge, and the Insolvency Act 1986 and Insolvency Rules 1986 continue to apply.

### Bankruptcy Restriction Order ("BRO")

Only the Secretary of State can apply for a BRO where the bankrupt has not complied with his obligations. The effect of a BRO is to extend the period during which the disabilities resulting from bankruptcy apply. The insolvency service can accept a bankruptcy restriction undertaking to avoid the cost of applying to court for an order.

The application has to be made within one year of the bankruptcy order but the court has power to extend the time. A bankruptcy restriction order/undertaking lasts between 2-15 years. During this period the disabilities resulting from bankruptcy (e.g. disqualification as a director, restrictions on credit etc.) continue to apply.

There are various grounds for a BRO including failure to keep records in the two years pre-petition to date of application for a bankruptcy restriction order, gambling, rash, hazardous speculation or

unreasonable extravagance materially contributing to the bankruptcy and failure to supply goods or services (paid for by a creditor).

### Annulment of bankruptcy

The court has the power to annul a bankruptcy order where the order ought not to have been made or 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 in full or secured to the satisfaction of the court or where an Individual Voluntary Arrangement ("IVA") is approved in regard to an un-discharged bankrupt. The court has the power to annul whether or not the bankrupt has been discharged.

### IVA

The Insolvency Act 1986 sets out a procedure which enables a debtor to make a proposal for a voluntary arrangement with his creditors as an alternative to bankruptcy. The arrangement must take the form of a composition in satisfaction of his debts or a scheme of arrangement. The advantage of an IVA is that it avoids bankruptcy and its associated disabilities, obligations and stigma. The assets do not vest in the supervisor and the debtor remains in control over his assets. Certain assets can be excluded from the arrangement (although creditors will seek to be compensated for this) and it binds all creditors. The disadvantages are that the debtor will have to pay proposed nominees, costs and court fees, if an IVA is not approved it is likely that the debtor will be made bankrupt and an IVA requires the support of more than 75% (in value) of creditors. The duration is also likely to be for longer than one year, particularly if making contributions from income.

For further information please contact Louise Engel (020 7842 1493) or Brendan Herbert (020 7842 1472). The information in this guide is provided as a general review and does not constitute legal advice. Detailed specialist advice should always be taken before taking or refraining from taking any action.