

PART C: PRINCIPLES OF INSOLVENCY - PERSONAL INSOLVENCY

Part C2 – Personal Insolvency – Bankruptcy

Bankruptcy is a process by which the assets of a debtor are realised and distributed amongst his creditors. Bankruptcy is a Court procedure. All bankruptcies are commenced by the issue of a bankruptcy petition.

Creditors Bankruptcy Petition

A creditor can only present a bankruptcy petition against a debtor if:

1. The debtor owes more than £5,000.00 to the creditor and cannot pay that debt.
2. The debtor will, in the future, owe more than £5,000.00 to the creditor and there is no reasonable prospect of the debtor paying the creditor when the debt falls due.

Although it is ultimately a question of fact, a Court will presume that a debtor cannot pay his debts if the debtor fails to satisfy a statutory demand served on him by the creditor.

The bankruptcy petition must give full details of:

1. The debtor (including the debtor's full name and any trading names under which he carries on business).
2. The debt that the creditor claims from the debtor.

The creditor is to arrange for personal service of the bankruptcy petition on the debtor. If the debtor avoids service, the creditor can ask the Court to order that an alternative means of service (such as posting the bankruptcy petition through the letterbox of the debtor's residential address) is effective.

When the Court issues a bankruptcy petition it will list a hearing of the bankruptcy petition. The debtor may file evidence in opposition to the bankruptcy petition and any creditor of the debtor may attend the hearing and make representations to the Court.

The Court cannot make the debtor bankrupt if it is satisfied that either:

1. The debtor (taking into account all of his contingent and prospective liabilities) is able to pay all his debts.

2. The petitioning creditor has unreasonably refused an offer from the debtor to secure or compound the debt detailed on the bankruptcy petition.

Debtors Bankruptcy Petition

A debtor may present a bankruptcy petition against himself, on the ground that he cannot pay his debts. He must submit a statement of his assets and liabilities in support of the bankruptcy petition.

The Court will regard a debtor as **able** to pay his debts if, although he has insufficient liquid assets to meet his current liabilities, he could raise the necessary funds from his illiquid assets in a short time.

The process of a debtor's bankruptcy petition is usually swift. In some cases, the Court makes the Bankruptcy Order on the same day as the bankruptcy petition is issued.

Effect of Bankruptcy Order

On the making of a Bankruptcy Order, the Court passes its files to the Official Receiver. The debtor must deliver to the Official Receiver:

1. Possession of the assets within his bankruptcy estate.
2. An inventory of his assets.
3. All books, papers and records relating to his affairs.

The Official Receiver will decide whether or not it is appropriate to appoint an independent insolvency practitioner as Trustee in Bankruptcy ("Trustee"). Upon the appointment of a Trustee:

1. The debtor's beneficial interest in the assets and property that falls within his bankruptcy estate automatically vests in the Trustee.
2. The Trustee's role is to realise the value of the assets within the debtor's bankruptcy estate and distributes the realised proceeds among the debtor's unsecured creditors.
3. The debtor's creditors are also generally bound to accept the distribution of assets made by the Trustee in settlement of the bankruptcy debts owed to them and cannot take any other action against the debtor to recover the debts.

A Bankruptcy Order has a significant effect on the debtor including:

1. An impact on his ability to borrow and trade.
2. Preventing a debtor from acting as a director of a company or be involved in the management, promotion or formation of a company (whether directly or indirectly) unless the Court grants him permission to do so.
3. Preventing a debtor from obtaining credit in excess of £500 (by himself or jointly) without disclosing to the lender that he is an undischarged bankrupt.
4. Prevents a debtor from trading under a different name from the one in which the Bankruptcy Order was made, without informing all those who trade with him under his new name, that he is an undischarged bankrupt.
5. Preventing a debtor from practicing as a solicitor, act as a trustee of a charity or a pension trust, an account manager of an individual savings account or as a plan manager of a personal equity plan

Respective positions and functions of Trustee and Official Receiver

Upon the making of a Bankruptcy Order, the Official Receiver will initially take control of the debtor's estate. The Official Receiver will oversee the first three points referred to above under "Effect of Bankruptcy Order". Thereafter, the Official Receiver will decide whether or not a Trustee is to be appointed.

As set out above, the debtor's bankruptcy estate vests in the Trustee upon his appointment. This vesting is automatic and takes place without the need for any documentation to effect or evidence the transfer of title to the Trustee.

The primary function of a Trustee is to realise the value of the assets within the debtor's bankruptcy estate and to distribute the asset realisations to satisfy, as far as possible, the debtor's bankruptcy debts. The Trustee can propose an IVA for the debtor to make such a distribution, a route used most typically where the bankrupt debtor carries on a trading business.

The Trustee has wide-ranging powers including:

1. Avoid any disposition of property by the debtor made after the presentation of the bankruptcy petition, unless that disposition was approved in advance by the Court or the Court subsequently ratifies the disposal in question; such a disposition is void for all purposes and not just against the Trustee or at his instigation.
2. Compelling parties, including the debtor himself, with knowledge of the debtor's affairs to provide that information to the Trustee.

3. Challenging any disposition of assets by the debtor at an undervalue in the five years before the Bankruptcy Order.
4. Challenging any preference given by the debtor to any creditor in the six months before the Bankruptcy Order or, if the preference was given to a connected party, two years before the Bankruptcy Order.
5. Challenging any agreement made three years before the Bankruptcy Order under which the debtor was given credit on extortionate terms.
6. Disclaiming any onerous property, including any leasehold property of the debtor.
7. Clawing back excessive contributions made by the debtor to his pension scheme, to the extent that the making of such excessive contributions unfairly prejudiced the debtor's creditors.

Assets forming part of the bankruptcy estate

The debtor's bankruptcy estate comprises all assets and property in which the debtor has a beneficial interest at the date of the Bankruptcy Order, except:

1. The tools of the debtor's trade (including vehicles), although the Trustee can require the debtor to replace the tools of his trade with cheaper equivalents if the cost of replacement would be less than the realisable value of the existing tools.
2. Assets necessary for the basic domestic needs of the debtor and his family.
3. Assets to which the debtor has solely legal title.
4. Property held by the debtor under an assured tenancy, protected tenancy or protected occupancy of a dwelling house.

The beneficial interest of the debtor in his own sole or principal residence (or his interest in the sole or principal residence of his present or former spouse or partner) will vest in the debtor's Trustee. This interest in the property is subject to any charge on the property in favour of the debtor's spouse arising under the Family Law Act 1996. The practical effect of this is to allow a spouse to remain in occupation of the matrimonial home pending a final order in divorce proceedings. The section does not give the spouse of a bankrupt debtor any form of proprietary interest superior to that of the Trustee.

The debtor's beneficial interest in such property will automatically re-vest in the bankrupt **three years** after the Bankruptcy Order, unless, by then, the Trustee has:

1. Realised the debtor's interest in the property.

2. Applied for an order for sale of the property.
3. Applied for an order for possession of the property.
4. Applied, under section 313 of the IA 1986, for an order that a charge be created against the property in favour of the bankruptcy estate, so that the proceeds of any future sale of the property are used to discharge the bankruptcy debts before passing into the hands of the debtor; or
5. Agreed that the bankrupt can reacquire his interest in the property, in return for an increase in the amount he owes in his bankruptcy.

If the Trustee makes an unsuccessful application in respect of the debtor's residential property, the property will, on dismissal of that application, automatically re-vest in the debtor, unless the Court orders otherwise.

The debtor must notify his Trustee if, during the course of his bankruptcy, he acquires a beneficial interest in any property. This requirement does not apply where a bankrupt acquires an interest in a principal residence for himself or his spouse or partner.

The Trustee can then choose whether to include the recently acquired property within the assets available to satisfy the debtor's bankruptcy debts. If the Trustee decides to include any such "after-acquired" property in the assets available to meet the debtor's debts, he must serve notice to that effect on the debtor. Upon service of such a notice, the property in question immediately vests in the Trustee with effect from the date on which the debtor acquired his interest in the property.

The Court can on the application of the trustee, make an order called an Income Payments Order. This will claim a portion of the debtor's income for such a period as the Court thinks fit. The Court cannot however, make an Order reducing the debtors remaining income below what appears necessary for meeting the reasonable domestic needs of the debtor and his family.

A similar arrangement can be made voluntarily between the debtor and his Trustee. This is called an Income Payment Agreement.

Sums recovered into the estate via an Income Payment Order / Agreement will be paid towards discharging the debts due to the debtors creditors.

Discharge of bankruptcy

A debtor is automatically discharged from bankruptcy on the first anniversary of his becoming bankrupt.

Once discharged from bankruptcy, a debtor has no further liability for his bankruptcy debts.

The discharge of a debtor from bankruptcy does not however, end the process of asset realisation and distribution. The debtor's Trustee remains in office for the purpose of completing the realisation of the assets within the debtor's insolvent estate. Any creditor owed a bankruptcy debt by the debtor may still claim its share of the asset realisations available for distribution, despite the debtor's discharge.

The Official Receiver or the debtor's Trustee can apply to Court to suspend this automatic discharge. In order to obtain a suspension of discharge, the Official Receiver or Trustee must satisfy the Court that the bankrupt has failed to comply with his duties under the IA 1986 in the course of his bankruptcy to date.

Suspending automatic discharge is a matter of discretion for the Court. The Court should consider whether it is in the public interest, bearing in mind the debtor's failure to comply with his statutory obligations, to keep the debtor subject to the restrictions that affect an undischarged bankrupt.

Annulment of a Bankruptcy Order

The Court may annul a Bankruptcy Order (whether or not the debtor has been discharged from bankruptcy) if either:

1. The grounds for making the order were not made out at the date that it was made; or
2. The debts (being those debts for which a creditor has lodged a proof of debt which has not been withdrawn) and expenses of the bankruptcy have been paid or secured to the Court's satisfaction.

In most cases, the burden is on the party seeking an annulment of a Bankruptcy Order to persuade the Court to annul the order. However, in the case of a debtor's bankruptcy petition, the burden of proof on an annulment application reverses, so that the debtor has to show why the Court should not annul his bankruptcy, if two conditions apply:

1. Despite being unable to pay his debts, the debtor has assets in excess of his liabilities.
2. The debtor has been dishonest in some way in obtaining the Bankruptcy Order.

The Court's discretion to annul a Bankruptcy Order is wide. In deciding whether to annul a Bankruptcy Order, the Court also review the validity of the debt on which creditor based the bankruptcy petition.

Upon the annulment of a Bankruptcy Order, any assets of the debtor vested in his Trustee automatically re-vest in the debtor.