Family

Insolvent divorces

Divorce, bankcruptcy...and the credit crunch. A painful combination, says **Michael Wilkinson**

IN BRIEF

- Family law practitioners are likely to be faced with an increasing number of insolvent divorces. Advising a divorcing party as to their likely award in the context of a looming or ongoing insolvency will rarely be a simple matter. Above all else, that advice is likely to turn, however, on the extent of the other's insolvency and the timing of any bankruptcy proceedings.

As the property market descends, once again, into negative equity, and banks and businesses everywhere, slam on their proverbial brakes and put a stop to their (previously generous) credit and loan facilities, the credit crunch looks set to hit home—and its impact is likely to affect more than merely the family purse. Married couples beware. Those finding it tough presently making ends meet, may soon be stretched beyond their limits and not only from an economic point of view.

Tales of insolvency and a break-up of the family unit are likely to become increasingly more commonplace. The consequence for the family law practitioner is that there are likely to be more than just two hungry parties looking for a slice of the family cake.

Surviving the wreck of a partner's bankruptcy can be hard enough in itself. Managing to salvage anything from it while also divorcing the bankrupt partner, is often impossible. The sad reality is that if the husband (and it usually is the husband, not the wife) is made bankrupt before ancillary relief proceedings are concluded, those proceedings, for most intents and purposes, will be dead in the water. Even if the bankruptcy occurs after the conclusion of ancillary relief proceedings, an award is still likely to be imperilled to some extent by a subsequent bankruptcy order.

Advising a divorcing wife as to her likely award in the context of a looming insolvency can be a perplexing task. Above all else, however, the advice is likely to depend upon the timing of any bankruptcy and the extent of the husband's insolvency.

"Just indebted"

Where the divorcing couple are only indebted and not yet insolvent, a court divvying up any assets, can take account of the parties' respective debts upon distribution. It notably cannot, however, renegotiate a contract between a creditor and a debtor, nor can it assign debts as between a husband and his wife.

Instead, what it can do, is to consider the effects and extent of any debts when applying the rationale for redistributing the parties' assets according to the principles of meeting needs, sharing in the assets and compensating one another (see *Miller v Miller; McFarlane v McFarlane* [2006] 3 All ER 1).

For example, a court may use its powers under s 23 of the Matrimonial Causes Act 1973 (MCA 1973) to increase the amount of payments due or to make a lump sum payable to an indebted party.

It may also demand an undertaking from that indebted party to use any award to pay off the debts or alternatively it may demand an indemnity from the other party to meet their ex-spouse's debts. It can (and often does) incentivise or pressurise parties into agreeing to give undertakings or indemnities by, for example, refusing to dismiss the other's claim if the same is not given.

Where a divorcing party is actually incapable of meeting their own liabilities however, ie where they are actually insolvent, there are unlikely to be any surplus assets for distribution at all—at least not from the bankrupt's side. In this regard, those who abandon ship before bankruptcy proceedings have even begun are generally best placed.

The bankruptcy petition has not yet been presented...

Where within two years before the presentation of the bankruptcy petition, a property adjustment order (PAO) is made against a (future) bankrupt, a court can only make an order setting aside the PAO if the consideration given for it was, in money or money's worth, "significantly less in value than the consideration in money or money's worth" as represented by the benefit of the PAO (see IA 1986, s 339). Interestingly, it would appear that unless there is direct evidence of fraud, misrepresentation, mistake or "dishonest collusion" a PAO (even one which is agreed by consent between the parties) will not be set aside as a transaction at an undervalue (see *Hill v Haines* [2007] EWCA Civ 1284, [2007] All ER (D) 56 (Dec) and for a high water mark authority see *Re Jones (A Bankrupt)* ([2008] BPIR 1051) which appears to suggest that even a PAO agreed

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between a husband and wife seeking to put a wife ahead of future creditors will not be set aside without evidence of actual dishonesty or fraudulent intention).

Furthermore, where a PAO is made between three to five years before the presentation of the petition, the court cannot even make an order under the Insolvency Act 1986 (IA 1986), s 339 unless the bankrupt was already insolvent when the PAO took effect, (the burden of proving solvency however will fall on the benefiting partner: IA 1986, ss 341(2), 435(2)(8)).

Where bankruptcy proceedings are already afoot, the party seeking ancillary relief is in a far more invidious position.

The bankruptcy petition has already been presented

Once the petition has been presented, any disposition of property (including a PAO) will be void save to the extent that it is later ratified by the bankruptcy court (IA 1986, s 284).

Unfortunately for the wife with the insolvent husband, the bankruptcy court will not ratify any disposition of property which effectively results in a "pre-bankruptcy creditor" being paid in full at the expense of other creditors in the absence of any special circumstances making the same desirable for the general body of the unsecured creditors (for the applicable principles, albeit in the context of company law under s 127 IA 1986 (see *Re Gray's Inn Construction Co Ltd* (1980) 1 WLR 711, [1980] 1 All ER 814, CA at 718A).

The bankruptcy order has already been made...

Where the bankruptcy order has already been made, the husband will no longer even own or have an interest in "his property": it will vest automatically in the trustee in bankruptcy upon his or her appointment. The trustee will then hold such property and realise its value subject to any rights others may have in it. Once the property has vested, no order under MCA 1973 can affect it.

Unfortunately for the wife, "property" is defined extremely widely (IA 1986, s 283). It includes every description of property and interest belonging to or vested in the bankrupt (IA 1986, s 436).

Even property which the bankrupt receives after bankruptcy and before his discharge may be claimed by the trustee (and claimed retrospectively as if vesting at the date of the bankruptcy) upon serving written notice. Such after-acquired property if disposed of will also be recoverable by the trustee (save as against equity's darling).

Property which will not vest however includes income. It also includes tools, books, vehicles (of a reasonable value), items/equipment necessary for use in the bankrupt's employment, business or vocation (IA 1986, s 283(2)(a)) and clothing, bedding, furniture, household or other equipment necessary for satisfying the domestic needs of the bankrupt and his family (IA 1986, s 283(2)(b)).

As income does not vest in the trustee in bankruptcy, periodic payment orders (PPOs) can continue to run and be enforceable despite the fact of the bankruptcy. The trustee in bankruptcy may however apply to the court for an income payment order (IPO) in order to make the bankrupt's income or part of it available to the creditors. The bankruptcy court may only make an IPO insofar as the same does not reduce the income of the bankrupt below what appears to the court to be necessary for meeting the reasonable domestic needs of himself and his family (IA 1986, s 310(2)).

Since PPOs often make more generous provision for a parties' needs than IPOs, a conflict arises between the family courts (who grant PPOs) and the bankruptcy courts (who make IPOs). The general rule, wherever there is conflict, is that a PPO will give way to an IPO. If a family court is asked to make a PPO after an IPO has already been made, for example, the court has to limit itself to the residue available after the IPO.

If the wife wants to enforce a lump sum order (LSO) or the costs of legal proceedings, presuming the property has already vested in the trustee in bankruptcy, she may wish to prove a debt in the bankruptcy. In this respect, LSOs and costs will constitute debts for the purpose of the IA 1986. Whether or not the wife will be able to prove those debts however is another matter, which will depend quite arbitrarily, on the date when the bankruptcy order was made.

Whether or not an award which is a debt is provable will depend, quite irrationally and arbitrarily, on the date when bankruptcy order was made. Where the bankruptcy order is made before 1 April 2005, LSO and costs are not provable and the wife cannot share rateably in any distribution of the assets. Her only recourse is to wait until the husband is discharged from his other debts and then seek to enforce the award.

Where the order is made after 1 April 2005, however, an LSO or a costs order will be provable in the bankruptcy (see IA 1986, ss 281(5)(b) and 324(1)). In either case (whether the debt is provable or not), the ex-wife can seek to enforce her award after discharge of the bankruptcy, providing her action is not otherwise time barred under the Limitation Act 1980.

Saving the family home

Where the bankrupt has an interest worth more than £1,000 in the family home, the trustee in bankruptcy can within three years of the bankruptcy apply to sell the home and providing more than one year has past since the vesting of the property in the trustee in bankruptcy, the court will assume unless the circumstances are exceptional that the interests of the creditors outweigh all other considerations (see IA 1986, ss 335-337). Sadly, "exceptional" circumstances are notoriously difficult to establish.

Where a family's circumstances clearly go beyond the ordinary and repossession is likely to unfairly impact upon those special circumstances the court may however consider postponing an order for possession or refusing one altogether (see *Martin-Sklan v White* [2006] EWHC 3313 (Ch), [2006] All ER (D) 77 (Nov)). In reality exceptional circumstances are rarely found and the courts are otherwise bound to give possession and permit sale. NLJ

Michael Wilkinson is a barrister practising predominantly in chancery and commercial law at 18 St John Street Chambers in Manchester: *www.18sjs.com*