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MATRIMONIAL PROCEEDINGS & BANKRUPTCY
SGH SEMINAR KEYNOTES

1. Introduction

These keynotes are intended to give a brief overview of the impact of family proceedings in bankruptcy.

2. Overview of Family Law

The rights of parties under family law are governed primarily by the *Matrimonial Causes Act 1973* (“MCA”).

MCA allows parties to a marriage, and children of the family, to obtain financial relief.

The categories of obtainable financial relief are specified in *MCA* s21, which provides for:

- Financial Provision Orders (including periodical payments, periodical payments secured against an interest of the payor, and lump sums); and
- Property adjustment Orders (transfer/settlement of property to which the payee spouse is entitled)

When considering an action, the Family Division exercises its discretion, in making an Order, pursuant to *MCA* s25. In deciding whether or not to grant an Order for financial relief, the Family Division has a duty to consider all the circumstances of a particular case including certain specified matters. These specified matters include

“The income, earning capacity, property and other financial resources...which each of the parties has... or is likely to have in the foreseeable future...”¹

The objective of the Family Division is, by exercising its discretion, is to grant financial relief so as to place the spouses and the children in the financial situation that they would have been in had the marriage not broken down.

3. Consideration of Impending Bankruptcy in Matrimonial Proceedings

Since the Family Division must consider the financial resources of the spouses in the foreseeable future, at first blush it appears that the Family Division should consider the imminent bankruptcy or solvency of one of the parties when exercising its discretion. The Family Division is not obliged to do so.

In *Mullard -v- Mullard*²:

- The potential bankruptcy of the husband was drawn to the attention of the Registrar. The Registrar ordered that the matrimonial property be sold and the husband’s share be used to discharge his outstanding liabilities. Any balance remaining was to be paid to his wife in addition to her share of the property. In effect the Registrar effected a quasi-bankruptcy.
- On a second appeal, to the Court of Appeal, it was held that whilst the Court must have regard to the husband’s liabilities:

“...it was not right to prefer the claims of his creditors over the claims of the wife and children”.

¹ s25(2)(a) MCA 1973

² [1982] 3 FLR 330

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In this case the Family Division confirmed that the family Courts do not have a duty to prospective trustees when considering matrimonial proceedings³.

The fact that the Family Division does not owe a duty to the creditors of a divorcing spouse, and prospective trustees in bankruptcy, is in the writer's view unfair. The writer believes that the Court ought to consider both the interests of the creditors and that of the non-bankrupt/insolvent spouse⁴. Under Australian law there is provision⁵ (where bankruptcy proceeds an order made in the Family Division) for the matter as a whole to be referred back to the family Courts, and for the Court thereafter to make an appropriate order taking into account both the interests of the creditors and the non-bankrupt spouse. Australian legislation does however expressly provide that the making of a bankruptcy order shall not invalidate any property adjustment order, or the rights of the non-bankrupt spouse to enforce any remedy in respect of a maintenance order⁶.

After a bankruptcy petition has been presented, within the jurisdiction, the Court having jurisdiction has the power to stay any proceedings affecting the property of the bankrupt⁷. Following the making of a bankruptcy Order the trustee ought to consider whether to apply for a stay of any ongoing matrimonial proceedings.

4. Rights of Trustee in Matrimonial Proceedings & vice versa

4.1 The Trustee's rights in family proceedings

Relief pursuant to MCA is personal. It is available solely to the spouse and children of a bankrupt. A trustee cannot claim financial relief from a spouse under MCA.

There is nothing preventing a bankrupt for applying for periodical payments, from a spouse, under MCA. If a bankrupt does make such an application, the provisions of *s310 Insolvency Act 1986* (Income Payments Orders) ought to be considered by his trustee.

A trustee cannot (or ought not to) be joined as a party to family proceedings unless there is an issue, between the trustee and the non-bankrupt spouse, which it is just and convenient for the Family Division to decide⁸

If a trustee wishes to be joined as a party to matrimonial proceedings, the onus is on the trustee to show that there is such an issue between the trustee and the non-bankrupt spouse. A relevant issue may arise when divorce proceedings have been instigated, prior to presentation of a bankruptcy petition, but which are not concluded prior to the bankruptcy order, where the ongoing matrimonial proceedings involve an application for a property adjustment order. In such an instance, the trustee may have grounds to be joined as a party to the matrimonial proceedings. However, a trustee may prefer recourse to Courts with insolvency jurisdiction instead. Notwithstanding the existence of separate matrimonial proceedings, there is nothing to prevent the trustee from doing so.

The judgment in *Re Flint*⁹ is authority that a trustee is not automatically bound by any order made, in the Family Division, with regard to property. Extrapolated to its logical conclusion, the judgment could theoretically be construed to suggest that a trustee is not necessarily bound by any order made in the Family Division. Such a construction is ultimately unlikely to be accepted by the Court.

4.2 Spouse's Rights in the Bankruptcy

³ confirmed in *Platt -v- Platt* [1976] 120 sol Jo 199 CA

⁴ s25 MCA 1973

⁵ Australian Bankruptcy Act 1966

⁶ s58(5A) & s123(6) Australian Bankruptcy Act 1966

⁷ s285(1) Insolvency Act 1986

⁸ *Albert -v- Albert (a bankrupt)* 1996 BPIR 232 CA

⁹ (a bankrupt) [1993] Ch 319

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The non-bankrupt spouse may be able to apply for annulment where a bankruptcy order has been made, for example on a debtor's petition, with a view to placing assets beyond the reach of the non-bankrupt spouse.¹⁰ In such circumstances the bankruptcy order may effectively constitute an abuse of process by the debtor.

In the event that the payor spouse (in matrimonial proceedings) has not paid any lump sum, periodical payments, or assessed costs, the payee spouse is a creditor within *Insolvency Act s383(1)*.

A former spouse can present both a statutory, demand and a bankruptcy petition against the defaulting co-spouse¹¹.

However there may be little/no benefit in a spouse petitioning for the bankruptcy of a co-spouse, since:

- Unless a divorce is completed prior to the presentation of a bankruptcy petition, *s329 Insolvency Act 1986* applies. Debts due to a spouse (as at commencement of bankruptcy) will rank after other creditors. This will not apply to loans made by a former spouse, to the bankrupt, following divorce. Such loans will rank *pari passu* with unsecured creditors (as appropriate).
- Any obligation of a bankrupt in family proceedings¹², maintenance or assessment pursuant to the Child Support Act 1991, do not constitute provable debts in bankruptcy¹³. It is somewhat of an anomaly that such debts nevertheless fall within the definition of a bankruptcy debt¹⁴.
- Although obligations of a bankrupt in family proceedings are not provable in bankruptcy, this is likely to be different if the bankrupt's obligations are pursuant to divorce proceedings out of the jurisdiction. In *Cartwright -v- Cartwright*¹⁵ a spouse attempted to petition for the bankruptcy of her husband based on orders made in the Family Division in Hong Kong. Mr Justice Rimer J held that orders made in the Family Division in Hong Kong did not fall within the definition of business assigned to the Family Division within the jurisdiction. Since in this case the order had not been registered within the jurisdiction, the debt in question was provable in bankruptcy.
- As stated above, assessed costs orders in family proceedings are not provable in bankruptcy. In the case of *Russell -v- Russell*¹⁶, Mr Justice Chadwick J found otherwise. Whilst this particular issue was not argued before the Judge, Mr Justice Chadwick J took it upon himself to order that the assessed costs were a provable debt in bankruptcy. He was not referred to the relevant insolvency rules.
- Arrears of maintenance, or unsatisfied lump sum payment orders, are not debts from which a bankrupt is released following receipt of his discharge (save to the extent (and on such conditions) as the Court may direct)¹⁷.

As stated above a former spouse can present a bankruptcy petition. However, since there seems to be little benefit in the former spouse doing so, the Court might dismiss such a petition when exercising his general discretion whether or not to make a bankruptcy Order, or to dismiss a petition for any other reason.¹⁸ The Court may exercise such discretion, for dismissal, if there are no other provable debts as against the former spouse debtor.¹⁹

¹⁰ F –v- F 1994 1 FLR 359

¹¹ *Re a Debtor (No. 68/SD/1997)* [1998] 4 All ER 779; *Russell -v- Russell* [1998] BPIR 259

¹² as defined in s281(a) *Insolvency Act 1986*

¹³ *Insolvency Rule 12.3(2)(a)*

¹⁴ Pursuant to the definition provided by s382 *Insolvency Act 1986*.

¹⁵ CA 2001 (upon appeal) pursuant to s375 *Insolvency Act 1986*

¹⁶ [1998] BPIR 259

¹⁷ s281(5)(b) *Insolvency Act 1986*

¹⁸ ss264(2) & 266(3) *Insolvency Act 1986*

¹⁹ see also *Re a debtor* [1999] BPIR 206

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Since lump sum orders are not provable in bankruptcy²⁰, and although non-bankrupt spouses are creditors for the purposes of s383 Insolvency Act 1986²¹, non-bankrupt spouses enjoying the benefit of orders made in family proceedings are capable of being bound by an individual voluntary arrangement. However since the non-bankrupt spouse is entitled to pursue matrimonial debts following discharge, an attempt to bind a non-bankrupt spouse by the terms of an IVA is capable of constituting unfair prejudice pursuant to s262 Insolvency Act 1986²²

5. Payments pursuant to a Family Division order post-presentation

Section 284 Insolvency Act 1986 provides that any disposition of property by a bankrupt, on or after the day of presentation of the petition, is void subject to subsequent ratification by the Court.

Consequently payments made by the bankrupt post-presentation to his spouse (for example, periodical payments made under a matrimonial order) are prima facie void.

This includes any lump sum paid post-presentation, pursuant to a financial relief order, or disposition of property under a property adjustment order.²³

If in matrimonial proceedings the Court orders that a lump sum be paid into Court, and the sum is paid in prior to presentation, the spouse in whose favour (to the credit of the action) the lump sum has been paid becomes a secured creditor. The trustee will not be able to recover the same under s284 Insolvency Act 1986 if this lump sum is subsequently paid to the other spouse²⁴.

6. Adjustment of prior transactions

6.1 Introduction

A person, who suspects that he/she may shortly be adjudged bankrupt, may seek professional advice from an insolvency practitioner and/or solicitor. If a divorce is “concluded” prior to the presentation of a petition, this may protect parts of the debtor’s estate from his future trustee in bankruptcy. By completion a divorce the parties have a greater degree of control over the proceedings and division of assets. A trustee of course will not be a party to matrimonial proceedings concluded prior to his appointment.

Section 39 MCA (as amended) provides that a property adjustment order in the Family Division:

“...shall not prevent that settlement or order from being a transaction in respect of which an order may be made under sections 339 or 340 Insolvency Act 1986”

-transactions at an undervalue and/or preferences

Nevertheless, Courts with insolvency jurisdiction will wish to see a good reason for looking behind any order made in the Family Division.

6.2 Spouses as associates

The definition of “associates” provided by *s435 Insolvency Act 1986* includes spouses (s435(2)) and former spouses (s435(8)).

²⁰ Insolvency Rule 12.3

²¹ *Re Bradley-Hole* [1995] 1 WLR 1897

²² *Re a Debtor* (No.48810 of 1996)

²³ *Re Flint* (a bankrupt) [1993] Ch 319; *Treharne & Sand –v- Forrester*

²⁴ *Re Mordant -v- Halls* [1995] BCC 209. In this case, the money itself was not even paid into Court. It was paid to the husband’s solicitors who it was held were holding the monies on behalf of the Court.

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6.3 Relevant time

s341 Insolvency Act 1986 defines the same with regard to bankruptcy, as follows:

- Transaction at an under-value - 5 years ending with the date of presentation of the petition. Where a transaction at an under-value is made more than 2 years prior to presentation of a petition, it will not constitute a transaction at an undervalue unless the debtor was either insolvent at that time, or became insolvent as a result of the transaction. These conditions are presumed to be satisfied if the transaction is with an associate²⁵;
- Preference to an associate - 2 years ending with the date of presentation of the petition;
- Preference, to non-associates - 6 months ending with the date of presentation of the petition.

It is important to ascertain when payments take effect, pursuant to orders made in the Family Division. The effective dates are:

- Periodical payments and lump sum orders - property passes as and when the payments are paid.
- Secured periodical payments orders - creates an immediate equitable charge, as at the date of order, against the property against which the periodical payments are secured²⁶. However, such equitable charge does not "bite" before the making of the decree absolute - *MCA s23(5)*.
- Property adjustment orders (including settlement orders). Until recently it had been held that a property adjustment order did not in itself affect a disposition of property, and that the disposition only took place where the necessary steps to effect a physical transfer of the land (i.e. executing an HMLR transfer) were taken²⁷. However the Court of Appeal in *Mountney -v- Treharne* overturned these principles²⁸. In this case it was held that, subject to the decree absolute being made prior to commencement of bankruptcy, the making of the property adjustment order in itself created an equitable interest in favour of the non-bankrupt spouse. Although the interest in the matrimonial home would fall within the estate in bankruptcy, assuming transfer has not been completed prior to bankruptcy, any trustee in bankruptcy appointed would take the property subject to the non-bankrupt spouse's equitable interest created by the property adjustment order²⁹.

6.4 Transactions at an undervalue

There is very little case law with regard to the interaction between matrimonial proceedings and s339 Insolvency Act 1986.

To establish a transaction at an undervalue, the trustee needs to show:

1. That the bankrupt entered into a transaction; and
2. An undervalue within a relevant time.

²⁵ s341(2) Insolvency Act 1986

²⁶ *Mosey -v- Mosey & Barker*

²⁷ *Beer -v- Higham (a bankrupt)* [1997] BPIR 349

²⁸ [2002] EWCA Civ 1174

²⁹ in view of the construction of s283(5) Insolvency Act 1986. The decision in *Mountney -v- Treharne* was based on *MacLurcan -v- MacLurcan* [1897] 77 LT 474. It is highly arguable that the reasoning in *MacLurcan* is capable of being overturned, although the Court of Appeal was bound by this judgment. A petition to appeal the House of Lords was not filed in *Mountney -v- Treharne*, although leave to appeal was granted by the Court of Appeal.

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“Transaction” is defined by s436 *Insolvency Act 1986*, and includes agreements. It is clearly arguable that entering into an order, by consent, in matrimonial proceedings, constitutes a transaction for the purposes of s339 *Insolvency Act 1986*.

The position with regard to contested proceedings is more difficult. *Re O’Shea’s Settlement*³⁰ suggests that inter partes litigation is capable of constituting a transaction. However this authority is old, and questionable.

It must also be questioned whether a disposition, made pursuant to an order in matrimonial proceedings, can constitute a transaction at an undervalue. How will the Court (exercising insolvency jurisdiction) assess “undervalue”. The writer’s view is that the Court will apply common sense. For example, if an order for transfer of property in matrimonial proceedings provides that each of the parties are to receive 50% of the net equity, this is likely not to be a transaction at an undervalue. The spouse has not acquired anything to which the bankrupt was in reality previously entitled - subject to the evidence in each instance.

*Re Abbot (a bankrupt)*³¹ must be considered when assessing “value”. Even if the spouse receives more than 50% of the equity, this is not necessarily a transaction at an undervalue. In *Abbot* the Court recognised that the spouse has a right to financial relief (in matrimonial proceedings), and that this relief in itself has an intrinsic value. In other words, in return for the extra share of the net equity (over and above 50%) received pursuant to a matrimonial order, the spouse is in return relinquishing her rights to financial relief, thereby providing value (application of *doctrine of replacement*).

Although *Abbot* is a pre 1986 case, there is nothing in the insolvency legislation to suggest that the government intended to reverse the principle established.

It is therefore difficult for a trustee to look behind an order for the disposition of land. If an application is made, the Court (exercising insolvency jurisdiction) will when considering a property adjustment order, or lump sum order, need to be satisfied that:

- The Family Division could have properly made this order; and
- The parties made it on the basis of full and frank disclosure

This will not amount to a full re-examination of the evidence. If the Court (exercising insolvency jurisdiction) is not satisfied as to the above, it is likely that it will set the same aside as a transaction at an undervalue.

The above is supported by *In Re Kumar (a bankrupt)*³². The trustee made an application concerning a transaction at an undervalue. Mr Kumar transferred his property, prior to divorce, to his wife for “love and affection”. No financial consideration was provided. Mr and Mrs Kumar subsequently divorced. Since the property had already been transferred, the Family Division did not consider the property in the family proceedings. It became apparent that the true motivation behind the transfer was that Mr Kumar was a defendant to negligence proceedings, and it was clear that a judgment would be made against him in the future. Whilst finding a transaction at an undervalue, *Mr Justice Ferris* stated that the transfer of Mr Kumar’s interest in the matrimonial home was effectively the disposition of his only remaining capital asset of any significance. He opined that the Family Division would not, had they been aware of the true circumstances, made a property adjustment order in favour of the non-bankrupt spouse.

In brief the Court, exercising insolvency jurisdiction, will need to be satisfied that an order made in the Family Division is wholly incorrect and ought not to have been made at the relevant time. Effectively, what a trustee will be appealing is the exercise of the Family Division’s discretion.

Especially in matrimonial proceedings, a prudent trustee should also consider the provisions of s423 *Insolvency Act 1986 - Transactions Defrauding Creditors*. This may be applicable in

³⁰ [1895] 1 Ch 325

³¹ [1983] Ch 45 DX

³² [1993] Ch 319

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situations where transactions have been effected between husband and wife, even many years ago, that on the face of it appear to be a sham³³.

6.5 Preferences

In order to show a preference, a trustee must show:

- That the person receiving the payment is a creditor etc; and
- That as a result of the purported payment, that creditor has been placed in a better position than had the payment not been made.

A preference can theoretically arise pursuant to a Court order. As such, preferences can arise notwithstanding orders made in the Family Division.

It is unlikely that dispositions of property, and in particular property adjustment orders, are capable of constituting voidable preferences. Since the spouse/former spouse is an associate, there is a presumption of intention to prefer - s340(5) *Insolvency Act 1986*. This presumption is rebuttable. If the payor spouse simply states that he/she had no choice but to make the payments, in view of a Court order, it is likely that this presumption will be rebutted.

One has to consider the terms of the order in question in each instance. In particular:

- Did the bankrupt consent to the order being made?
- Is/are the payment(s) clearly excessive?
- Can it be successfully alleged that the orders were entered into with an intention to place the funds beyond the reach of creditors?

6.6 Voidable dispositions

If a property Adjustment Order is made following presentation of a bankruptcy petition, it may be capable of being set aside as a voidable disposition.³⁴ In *Re Flint*³⁵ it was confirmed that a Property Adjustment Order is capable of constituting a 'disposition' for the purposes of s284 *Insolvency Act 1986*. This line of reasoning was approved in *Treharne & Sands -v- Forrester*³⁶

7. Obligations of bankrupt spouse, post-bankruptcy, vis-à-vis, matrimonial orders

This section deals with periodical payment orders made in the Family Division.

7.1 Effect of bankruptcy

Bankruptcy does not release a bankrupt from his obligations under orders made in the Family Division. Periodical payment orders result in liabilities that accrue post-bankruptcy.

The bankrupt can apply, in the Family Division, for a variation to reduce the quantum of the periodical payments in view of bankruptcy.

7.2 Income Payments Order

A periodical payments order does not debar a trustee from making an application for an income payments order³⁷. As explained above, the bankrupt is entitled to apply for a variation/reduction of the periodical payments order. When ascertaining whether the income

³³ See also *Midland Bank Plc -v- Wyatt* [1996] BPIR 288

³⁴ pursuant to s284 *Insolvency Act 1986*

³⁵ [1993] Ch 319

³⁶ 2004 BPIR 339

³⁷ s310 *Insolvency Act 1986*

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of a bankrupt is excessive, the trustee ought also to consider whether he considers that the quantum of any periodical payments order is excessive.

The Family Division, when making a periodical payments order, is concerned to ascertain the amount of the bankrupt's income, and to decide how much ought to be made available to support the spouse and children. In *Albert* the Court considered s310 *Insolvency Act 1986*, made an income payments order, and held that following an income payments order the bankrupt could apply to the Family Division to reduce the quantum of the periodical payments order.

In brief, a trustee can apply for an income payments order notwithstanding that a periodical payments order has previously been made in the Family Division. The Court will consider the quantum of the bankrupt's income and his reasonable expenses. It will make an income payments order accordingly. Thereafter, the bankrupt can apply to the Family Division for a reduction/variation in the periodical payments order (if appropriate).

8. Summary and Conclusion

The interaction between insolvency and matrimonial proceedings is complex. Certain areas (in particular preferences) remain untested as a matter of law. A trustee is not deprived of his powers by divorce. Rather the onus of proof is shifted. By concluding divorce proceedings prior to bankruptcy, a division of assets (supported by Court Order) has taken place prior to the vesting of the estate in the trustee. To question the same, a trustee must show that the division was unreasonable and that the Family Division ought not to have made the order that it did.

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