

## Bankruptcy

### Overview

Bankruptcy is intended to relieve individuals from liabilities when they are no longer able to settle them. It is appropriate where there are no obvious advantages in arranging a rescheduling or reduction of those debts through an individual voluntary arrangement (IVA).

It is not however an efficient way of realising assets for the benefit of creditors, with many of its procedures dating back to 19<sup>th</sup> and early 20<sup>th</sup> Century when attitudes to bankruptcy were different. Assets are usually sold piecemeal and continuing to trade a business to preserve value for creditors is almost impossible. The trustee who manages the bankruptcy does however have wide powers to deal with previous transactions that have adversely affected creditors and so bankruptcy can often follow fraud situations.

The Enterprise Act 2002 updated the bankruptcy procedure. These changes are intended to differentiate between the “honest” and “delinquent” bankrupt, generally making bankruptcy a more attractive procedure for those in the former category. These changes came into force in April 2004.

Even after the Enterprise Act 2002 upgrade, bankruptcy continues to offer poor returns for creditors because of the unwieldy nature and the costs involved.

[The Insolvency Services website also contains helpful further reading material on bankruptcies including practical steps for petitioning for bankruptcy as a debtor.](#)

### How does the procedure work?

A court is responsible for making a bankruptcy order against an individual if it is satisfied the debtor is insolvent. A bankruptcy order may be made on the petition of either a creditor owed more than £750 or the debtor. A supervisor of a creditor bound by an IVA can also petition if the debtor has failed to honour the terms of the proposal or provided misleading information to the creditors.

Once an order is made it must be advertised in The London Gazette. The bankrupt's assets fall under the control of a trustee. In the first instance, the Official Receiver (a civil servant) is appointed as trustee. He has a duty to investigate the bankrupt's affairs and send a report to the creditors. The bankrupt is required to attend an appointment with the Official Receiver who will question him and require details of his financial affairs to be provided, in particular a statement of affairs, comprising details of the debtor's assets and liabilities. He may decide to call a meeting of creditors within four months to allow them to appoint an insolvency practitioner as trustee and to establish a creditors' committee.

The trustee is responsible for realising the bankrupt's assets and distributing the proceeds to the creditors in the correct order of priority. If the debtor fails to co-operate with the trustee, the trustee may apply to the court for the debtor to be examined on oath in the presence of a judge. If the debtor continues to fail to co-operate he can be held in contempt of court and imprisoned.

Bankrupts are allowed to retain furniture and other basic domestic chattels, the tools of their trade and, in certain circumstances, a car or other transport if it is required for their work. A trustee may claim and realise any normally exempt items that he considers to be of excessive value, although he must provide the debtor with a reasonable replacement from the proceeds of realisation.

This document explains the relevant position only in general terms and omits details less commonly experienced for the sake of brevity. It is not intended to be used as formal advice about a specific situation, for which you should consult us specifically and not rely upon this document. Portland would be pleased to advise you formally and you should contact one of the directors listed on the website at [www.portland-solutions.co.uk](http://www.portland-solutions.co.uk) to arrange this or telephone our main switchboard on 01489 550440. Portland regrets it is unable to accept any responsibility to anybody who seeks to rely on this document.

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As with companies, any organisation or person who holds security, such as a mortgage, has first claim over the mortgaged assets. Any equity in excess of the debts of secured creditors in a property, even in the form of a house, must be realised. The trustee in bankruptcy may apply to the court at any time seeking an order for possession of a property to effect a sale. In the case of a matrimonial home, the bankrupt's spouse has various rights and the court will not normally grant an order in favour of the trustee at the expense of the spouse's rights of occupation in the first twelve months of the bankruptcy. Thereafter the creditors' interests are considered paramount. Trustees are permitted to consider a sale of the bankrupt's interest in a property to a third party such as the wife, avoiding the distress of an eviction and forced sale of the property.

The trustee in bankruptcy has the power to apply to the court to seek to set aside certain transactions that happened before his appointment, with a view to enhancing the value of the estate for the benefit of creditors. Typically such transactions could be making payments to favoured creditors but not others (preferences), disposals of assets at undervalues and putting assets beyond the reach of creditors.

The bankrupt must declare to the trustee all sources of income. If the trustee considers that the bankrupt has more income than is required to meet the reasonable domestic needs of the bankrupt and his family he may apply to the court for an income payment order requiring the 'surplus' income to be paid to him. The court will consider average incomes and costs of living in determining what is reasonable and not the lifestyle that the bankrupt may have enjoyed in the past.

Certain debts cannot be dealt with in a bankruptcy and are considered "non provable". These include matrimonial debts, gambling debts, and foreign taxes. These debts survive the bankruptcy and the debtor is not released from them.

During a bankruptcy until discharge, a bankrupt is subject to certain disabilities, the most important of which prevent him from the following.

- Acting as a director of a company, or being involved in the formation, promotion or management of a company
- Carrying on business under any name other than his own
- Incurring credit of £500 or more without disclosing his bankruptcy
- Sitting in either House of Parliament
- Acting as an elected local government officer

Bankrupts are not however legally prevented from operating bank accounts, although most banks decline to deal with undischarged bankrupts.

First-time bankrupts are now discharged after twelve months or sooner if the trustee completes his function before then. Subsequent bankruptcies last for at least five years and where a bankruptcy restriction order is granted by the court on the application of the trustee, the period can be extended up to fifteen years.

After the bankrupt is discharged he is released from the debts, which were provable in the bankruptcy, but the property comprised in his estate at the time of the bankruptcy order remains under the control of his trustee notwithstanding the discharge.

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There are substantial costs of administering a bankrupt estate. In a case with £20,000 of realisations the costs deducted, before funds are available to creditors, will usually exceed £12,000. These costs include the petitioning creditor's legal fees, the fee of the official receiver, the fee levied of 17% on all monies paid into the Insolvency Services Account and the fee of the trustee.

The main changes introduced by the Enterprise Act were:

- Where there are no irregularities and the debtor has co-operated, the length of the bankruptcy period was shortened from two/three years to twelve months or even earlier.
- In other cases, the trustee now has powers to apply to court for a bankruptcy restriction order so that the debtor is subject to the restrictions of bankruptcy detailed above for a longer period of up to fifteen years.
- A trustee has three years in which to decide whether to realise his interest in the matrimonial home, failing which it reverts to the debtor.
- In cases where the debtor has substantial income, a trustee can more effectively apply to court for an income payment order or reach an out of court settlement with the debtor.

| Advantages  | Disadvantages  |
|---|--|
| <ul style="list-style-type: none"> <li>▪ Deals effectively with liabilities that a debtor is unable to meet. Particularly suitable for consumer debt cases where the restrictions placed on a bankrupt do not have any material impact.</li> <li>▪ A trustee has wide powers to pursue a debtor and other parties when transactions have occurred that adversely affect creditors.</li> </ul> | <ul style="list-style-type: none"> <li>▪ Costs are significant and often out of proportion to the assets realised, particularly in smaller cases.</li> <li>▪ It is difficult to continue trading and any value associated with goodwill is lost.</li> <li>▪ Creditors do not often receive any worthwhile recover on their debts.</li> <li>▪ Depending on personal view, a debtor might consider that there is a stigma attached to bankruptcy.</li> <li>▪ Some professions prevent a bankrupt from acting.</li> </ul> |

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