

Bankruptcy in the Courts: Continuity in an Era of Change?

Introduction

The assertion that insolvency practitioners have had to face up to a maelstrom of legislative change in the past 18 months is no great revelation. Reforms brought about by the Small Business, Enterprise and Employment Act 2015 and the Deregulation Act 2015, coupled with the belated introduction of s. 71 of the Enterprise and Regulatory Reform Act 2013¹, would, at any time, have been difficult to assimilate. But, of course, matters have been exacerbated by the complete transition of the operational secondary rules to the Insolvency (England and Wales) Rules 2016 (SI 2016/1024) (hereafter “IR 2016”). The coming on stream of the Recast EU Insolvency Regulation (2015/848) has spawned further amendments to the 1986 Act and the IR 2016 – see the Insolvency Amendment (EU 2015/848) Regulations 2017 (SI 2017/702)². In this climate of legislative turmoil it is easy to lose sight of what the courts are saying about the law of bankruptcy. There is a great degree of continuity in this jurisprudence, which is reassuring in such troubled times.

Relevance of bankruptcy

The diminution in status of bankruptcy as a feature of the topography in personal insolvency law in England and Wales is now clear. It trails well beyond IVAs in terms of statistical significance and is now less prominent than the DRO procedure introduced in 2009³. The raising of the minimum debt to £5000 for creditor petitions⁴ and the introduction of the out of court adjudication procedure for debtors wishing to bankrupt themselves has had some impact upon the cases coming before the courts⁵. But in spite of this, cases of interest do arise and they have to be resolved by the judiciary.

The English bankruptcy regime is still comparatively generous to the debtor. Bankruptcy tourism from other EU Member States will not disappear overnight in spite of the liberalisation of the bankruptcy laws of certain Member States. It is unclear how the advent of the new adjudication procedure will impact on the position, but the ruling of Chief

¹ Which introduced the new out of court “adjudication” procedure replacing debtor petitions to the court in bankruptcy from 6 April 2016.

² Readers should note also the EURIP Implementing Regulation (2017/1105) which provides some standard forms necessary for the operation of the new regime.

³ Via the Tribunals, Courts and Enforcement Act 2007, Part 5.

⁴ See Insolvency Act 1986 (Amendment) Order 2015 (SI 2015/922).

⁵ But ironically it appears to have reversed the apparently inexorable decline of bankruptcy usage.

Registrar Baister in *Re Budniok*⁶ might suggest that established principles governing determination of the debtor's centre of main interests (COMI) will continue to apply. It is far too early to determine how the new rules on determining COMI for individual debtors found in Art 3(1) of the Recast EU Insolvency Regulation (2015/848)⁷ might affect the phenomenon of bankruptcy tourism in the English courts, but, in view of Brexit, any such change might be only of short term relevance.

Initiating bankruptcy

As has been the position for many years the procedure in a creditor-induced bankruptcy starts with a statutory demand. The demand must be for an enforceable bankruptcy debt in excess of £5000. This is clear from ss. 267 and 268 of the Insolvency Act 1986. In *Blavo v The Law Society*⁸ the court held that unspecified intervention costs incurred in respect of regulatory action with regard to intervention in a legal practice could not be treated as a liquidated sum and therefore the statutory demand should be set aside. In so deciding HHJ Klein refused to follow *Pyke v Law Society*⁹.

A common response to the statutory demand will be a set aside application. The grounds for set aside are now mapped out in IR 2016 r. 10.5(5). These replicate the position under rule 6.5(4) of the Insolvency Rules 1986. What is clear is that the court will be reluctant to entertain arguments that have already been run on a previous unsuccessful set aside application – see the comments of Henderson LJ in the Court of Appeal in *Harvey v Dunbar Assets*¹⁰.

If there is no set aside of the statutory demand, the creditor can proceed to present a bankruptcy petition. The rules on service¹¹ must be satisfied, but the courts take a pragmatic approach. It was reiterated by HHJ Karen Walden Smith in *Emmanuel v HMRC*¹² that the basic test is whether the creditor has done all that was reasonable to serve the statutory demand and petition on the debtor so as to bring these matters to his attention. However, if the rules on service have not been satisfied a bankruptcy petition cannot be allowed to proceed, a point confirmed by Jeremy Cousins QC sitting in the High Court in *Canning v Irwin Mitchell*¹³.

Once the court hears the petition it has a range of options open to it. It can dismiss the petition if the creditor has unreasonably refused an offer from the debtor to settle or

⁶ [2017] EWHC 368 (Ch). For comment see Watson [2017] 30 *Insolv Intell* (forthcoming).

⁷ For discussion of this measure see Fletcher [2015] 28 *Insolv Intell* 97.

⁸ [2017] EWHC 561 (Ch).

⁹ [2006] EWHC 3489 (Ch), an ex tempore decision of Blackburne J.

¹⁰ [2017] EWCA Civ 60.

¹¹ See in particular IR 2016 rr. 10.2, 10.3 (statutory demand) and 10.14 (petition).

¹² [2017] EWHC 1253 (Ch).

¹³ [2017] EWHC 718 (Ch).

compound or to provide security (see s. 271(3)). This it will rarely do, taking the view that the creditor should be given a degree of latitude as to its response to the debtor's offer.

The debtor will often try to forestall the court from making a bankruptcy order by arguing that the underlying debt is subject to some sort of appeal. The court is unlikely to be swayed by the existence of such an appeal because it takes the view that debts, especially those underpinned by court judgments, stand until reversed, but it will sometimes remind the creditor of the dangers to it in terms of potential adverse costs of proceeding to seek bankruptcy in such circumstances.

In *Choudhry v Luton BC*¹⁴ Newey J held that as the debtor had had the opportunity to challenge the statutory demand on the grounds now raised before the court hearing the petition, but had not taken the opportunity to do so, the court was entitled to make an immediate bankruptcy order and did not have to delay until a challenge to the underlying debt was made.

Appeals, annulments and reviews

This appears to be a more common phenomenon these days and is often fuelled by the failure of the debtor to engage with the bankruptcy process until too late in the day. From the debtor's perspective, this is a dangerous game to play.

If the court makes a bankruptcy order, it can be appealed. A question that often arises is whether the bankruptcy order can be stayed/adjourned pending the outcome of an appeal. Judicial attitudes vary here.

A bankruptcy order made on the back of a tainted debt or judgment is not void. It remains valid until annulled¹⁵. The court can annul under s. 282 of the Insolvency Act 1986 on the grounds that the bankruptcy order should not have been made in the first place or that the bankruptcy debts (and expenses) have been paid. On an annulment application the court can consider fresh evidence put before it¹⁶. If the application is for an annulment pursuant to s. 282 of the 1986 Act the bankruptcy will usually have been ongoing for some time. This means that a trustee in bankruptcy will have been appointed and a claim for remuneration and expenses will have accrued. No matter if the annulment is eventually granted, the court will protect this professional expectation of reimbursement. The Court of Appeal confirmed this in *Oraki*¹⁷

¹⁴ [2017] EWHC 960 (Ch).

¹⁵ *Oraki v Dean and Dean* [2017] EWHC 11 (Ch) (Robert Ham QC).

¹⁶ Indeed failure to consider fresh evidence submitted by the bankrupt could invalidate any decision made on the bankruptcy annulment application – see the comments of Morgan J in *Richards v Vivendi SA* [2017] EWHC 1581 (Ch).

¹⁷ [2017] EWCA Civ 403.

There is also the possibility of seeking a review of the bankruptcy order pursuant to s. 375 of the Insolvency Act 1986, but the courts will require exceptional circumstances to be present before going down this particular road.

The estate

The policy of the courts over decades has been to try to maximise the scope of the bankruptcy estate so as to enhance recovery prospects for creditors. That policy has been counteracted to some extent by judicial intervention, for example by the introduction of the “use it or lose it” rule for private dwellings now found in s. 283A of the Act. Trust assets are also excluded¹⁸. Pension entitlements can also fall outside the estate, but may be subject to clawback applications pursuant to ss. 342A-342C¹⁹.

The “tools of the trade” exemption in s. 283(2)(a) is well established and serves an important purpose in protecting the bankrupt’s ability to earn a living in the future. But its limitations were exposed in *Mikki v Duncan*²⁰ where the Court of Appeal doubted whether an intangible chose in action, such as the benefit of a contract, could be within the tools of the trade category. This cautious approach is sensible – any extension of the exemptions from the bankruptcy estate is a policy decision for the legislature.

Stewardship of trustee

The fact that a trustee in bankruptcy owes duties of care is well established and entirely appropriate.

Section 304 of the Insolvency Act 1986 is a key provision here as it deals with the parameters of liability and the procedures for initiating a claim under the provision. Leave is required if the trustee has been released under s. 299. There is some judicial disagreement as to its scope. In *Oraki* at first instance²¹ Proudman J appeared to express the view that s.304 was the sole source of a trustee’s duties and no common law elements of liability in negligence subsisted outwith (see para [34]). She further appeared to indicate at para [162] that a s. 299 release of the trustee would eliminate the possibility of any claim against the trustee save explicitly under s. 304. On appeal, in obiter dicta David Richards LJ disagreed on the point of the exclusive nature of s. 304²². David Richards LJ clearly had doubts about the s. 299 observation of Proudman J and refused to endorse it²³, but did not put forward a

¹⁸ On the trust exception s. 283(3) note *Abdulla v Whelan* [2017] EWHC 605 (Ch).

¹⁹ The prospects of obtaining an income payments order under s. 310 of the Act against an uncrystallised pension entitlement have been considerably reduced by *Horton v Henry* [2016] EWCA Civ 989.

²⁰ [2017] BPIR 490.

²¹ [2015] EWHC 2046 (Ch).

²² [2017] EWCA Civ 403 at para [217].

²³ [2017] EWCA Civ 403 at para [221].

conclusive view of his own on this specific matter as it was not necessary to determine the appeal. Future clarification on the interaction between these statutory provisions is therefore required.

Effective discharge of stewardship in bankruptcy must involve the full range and proper use of the trustee's powers. One such power is that of disclaimer of onerous assets pursuant to s. 315 of the 1986 Act. The potential scope of this extraordinary statutory power was considered by the court in *Abdulla v Whelan*²⁴. John Male QC (sitting in the High Court) held that the power of disclaimer could only be exercised against property that was actually vested in the estate rather than all property that might be under the control of the bankrupt. Therefore property vested in the bankrupt in his capacity as trustee could not be disclaimed as trust property fell outwith the estate. Such property remained with the bankrupt/trustee and legal consequences would inevitably flow from that outcome.

Discharge

The most contentious issue relating to discharge concerns the use of suspended discharge to encourage cooperation on the part of the bankrupt. The court has the power to suspend the 12 month automatic discharge if invited to do so under s. 279(3) of the 1986 Act. With the truncating of the bankruptcy period to a period of one year, suspension of automatic discharge becomes more likely particularly where securing cooperation from a bankrupt might prove difficult. A couple of recent cases exemplify judicial attitudes in regard to suspension applications.

In *Harris v Official Receiver*²⁵ Andrew Simmonds QC (sitting in the High Court) made the point that there may be more than one consecutive application to suspend discharge. Here a fixed period of suspension had not produced the required cooperation from the bankrupt so the court acceded to a further suspension application.

In *Weir v Hilsdon*²⁶ the bankrupt had not been forthcoming on matters relating to his income. Accordingly, the trustee sought to persuade the court to suspend discharge. The bankrupt objected, claiming that the suspension was merely designed to facilitate an application to the court for an income payments order (which could only be made during the period prior to discharge). Nugee J did not see any difficulty with this strategy; though he did indicate that it would not take the same view in cases where the trustee had simply been tardy in seeking an income payments order and was using suspension to make good on his own failings. That said, the court in *Weir* (supra) made an important procedural observation. It rejected the unspecific form of the order for indefinite suspension as

²⁴ [2017] EWHC 605 (Ch).

²⁵ [2016] EWHC 3433 (Ch), [2017] BPIR 444.

²⁶ [2017] EWHC 983 (Ch). For analysis see Patterson [2017] 30 *Insolv Intell* 85.

adopted in *Mawer v Bland*²⁷. Bankruptcy courts should take this point on board when dealing with suspension applications in future.

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²⁷ [2013] EWHC 3122 (Ch). In so doing the court in *Weir* approved the criticisms of the *Mawer* type suspension order made by Patterson in [2016] 29 Insolv Intell 21.