

PRIVATE CLIENT

Personal insolvency terms explained



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INTRODUCTION

Individuals are quite often faced with financial difficulties which may lead to consequences such as bankruptcy and the subsequent loss of their home. This booklet attempts to clarify the various insolvency terms and provide clarification of what the consequences of various insolvency events are.

In addition to the description below, individuals may face proprietary claims against certain assets they may own (for example possession proceedings against their residential home) which are not covered here. Please contact Francis Wilks & Jones if you have any queries on these and related issues or look on our website for other relevant downloads.

1 Bankruptcy

This is the most common term, which under the laws of the United Kingdom refers to personal insolvency only. It is quite often (particularly in the media) used to refer to company insolvency but this is incorrect when it comes the UK (although this is more acceptable in foreign jurisdictions such as the US).

A BANKRUPTCY ORDER

A Bankruptcy Order may be made by the Court on the petition of either a creditor (i.e. someone the individual owes money to) or the individual themselves (who is then referred to as “the Bankrupt”). As a result of bankruptcy, all of the Bankrupt’s assets and debts vest in someone called the Official Receiver. This is a Court representative whose job it is to deal with insolvency matters on behalf of the Secretary of State for Business, Innovation and Skills (“the Secretary of State”).

The Secretary of State is the politician who heads the Department for Business, Innovation & Skills. One of the many executive agencies within this department is the Insolvency Service, which includes the offices of the various Official Receivers throughout the United Kingdom and regulates the insolvency regime. All proceedings issued by the Insolvency Service are brought in the name of either the Secretary of State or the Official Receiver. However, the Secretary of State is never personally involved in such matters and it is normally an employee of the Insolvency Service who will approach the Bankrupt once a Bankruptcy Order has been made.

If a debtor files for their own bankruptcy (referred to as a “Debtor’s Petition”) then s/he must complete a detailed questionnaire of their assets and liabilities and pay a fee to the Court. This fee is currently £1,270, comprising a Court fee of £280 and a fee paid for to the Official Receiver of £990.

Alternatively, a creditor may file a petition in Court (commonly referred to as a “Creditor’s Petition”) and this must be personally served on the debtor. A hearing date will be listed at which the debtor can attend to make representations as to why s/he should not be declared bankrupt and at this hearing the Court will determine whether a Bankruptcy Order should be made. We can assist you in dealing with the bankruptcy hearing.

WHAT HAPPENS AFTER THE BANKRUPTCY ORDER IS MADE?

Following the making of a Bankruptcy Order, either on a Debtor's petition, a Creditor's petition or the petition of a Supervisor of an Individual Voluntary Arrangement (see below), the Bankrupt will receive a letter from the Official Receiver together with a detailed questionnaire, requesting that they attend an interview at the local Insolvency Service office and that the questionnaire be completed prior to the interview.

Non-attendance or non-cooperation can have very serious consequences, including a suspension of the bankruptcy (so the Bankrupt is never discharged), proceedings issued at Court for a Public Examination of the Bankrupt's affairs and even an arrest warrant can be issued against the Bankrupt for failing to cooperate.

WHAT HAPPENS TO THE BANKRUPT'S ASSETS?

All assets owned by the Bankrupt automatically vest in the Official Receiver upon the Bankruptcy Order being made. This includes their interest in his/her residential (or other) home and all other assets. Additionally, an application can be made for residual income received by the Bankrupt post-bankruptcy (usually from his/her earnings) to be paid into the bankruptcy estate. Assets acquired after the making of the Bankruptcy Order can also be required to be delivered up (e.g. an inheritance) although this is subject to very specific requirements and time limits.

THE TRUSTEE IN BANKRUPTCY

If assets do exist in the bankruptcy estate, the Official Receiver can call a meeting of creditors to appoint a trustee in bankruptcy ("the Trustee"). Alternatively, in certain circumstances, the Official Receiver will not seek creditors' views but instead appoint the Trustee under his/her delegated statutory authority.

The Trustee is usually a partner at a firm of accountants and is a duly qualified Insolvency Practitioner. S/he will take an appointment as Trustee in their capacity as officers of the Court and with the objective of acting in creditors' best interests.

They have annual reporting duties and must account for all asset realisations within the bankruptcy estate to creditors.

SELLING A BANKRUPT'S ASSETS AND DISTRIBUTING THE PROCEEDS

The selling of a bankrupt's assets (or "asset realisations") is the task of the Trustee. Any realisations are then distributed to creditors.

These distributions are after payment of a statutory list of specific expenses which must be paid before any of the remaining money is distributed to the creditors. These include the direct costs of selling assets (such as estate agents fees upon the sale of repossessed property), indirect costs incurred as part of their appointment (for example insurance costs that must be met as part of their role) and any legal costs in enforcing their interests (for example possession proceedings over property). Additionally, the Trustee will charge their own professional time profit costs for this appointment in a similar way to any other professional (i.e. accountants and solicitors).

DISCHARGE FROM THE BANKRUPTCY ORDER

Upon being declared bankrupt, the Bankrupt remains undischarged from bankruptcy for 12 months. Equally, an application can be made to Court for suspension of the bankruptcy discharge period, usually for grounds of non-cooperation either with the Official Receiver or the Trustee (described above), for an indefinite period.

Whilst undischarged a Bankrupt has certain restrictions to which s/he is subject, including a duty to disclose the bankruptcy to providers of credit and not to act as a director or in the promotion, formation or management of a limited company. Once discharged, whilst these restrictions do not apply, the Bankrupt's assets are not released from the bankruptcy estate and neither does it remove the duty of the Bankruptcy to cooperate with the Official Receiver or the Trustee on an ongoing basis.

In addition to the above, bankruptcy does of course have some long-lasting effects on credibility (especially if you are in a professional occupation) and in respect of your credit history.

APPEAL OF THE BANKRUPTCY ORDER

If you would like to remove the effects of bankruptcy then you can of course appeal the Bankruptcy Order immediately after it has been made. This depends on the individual circumstances and is a remedy that only remains available up to 21 days after the bankruptcy order has been made. Otherwise, it may be possible to agree to an individual voluntary arrangement with creditors prior to discharge, and have the bankruptcy order discharged if 75% of creditors approve such an arrangement.

ANNULMENT OF THE BANKRUPTCY ORDER

The remaining solution is annulment of the bankruptcy order.

The bankruptcy order can be annulled on certain statutory grounds where:

- 1. The Bankruptcy order should not have been made – this could be that the debt is disputed or was wrong, or that there was a procedural or technical error; or**
- 2. On the grounds that all debts and expenses of the bankruptcy have been paid off – this is the most common solution where the total amount of bankruptcy creditors are lower than the bankrupt's equitable interest in his/her home or other assets.**

Alternatively annulment may be pursued under (2) above on the basis that a third party will pay off all debts and expenses of the bankruptcy proceedings. This is most commonly used where the Bankrupt's spouse has a joint interest in the matrimonial home and either acquires the Bankrupt's interest from the Trustee or seeks an annulment of the Bankruptcy Order (if this is a less expensive route) to remove the threat of possession by the Trustee.

Francis Wilks & Jones can assist you on all aspects of bankruptcy

2 Individual Voluntary Arrangements ("IVA")

WHAT IS IT?

These are arrangements made with creditors by the debtor, to enable only a portion of the debts owed to them collectively to be paid. Quite often this can be 75%, 50% or, if the circumstances permit, only 25% (or much less).

HOW IS IT ORGANISED?

A proposal to creditors is normally drafted by the debtor with the assistance of an Insolvency Practitioner (who will subsequently act as supervisor of the IVA). Before he is appointed, he is referred to as "the Nominee" and after appointment as "the Supervisor".

The proposal will deal with assets, liabilities, the likely return to creditors, procedural matters, provision for expenses of the IVA and the Supervisor's fees (including how their fees are to be charged).

The Nominee will then draft a report on his view of the Proposal (i.e. its prospects of success) and file both the Proposal and his report in Court and send it to creditors with a notice of a date for a meeting of creditors.

Prior to, or at, the creditors meeting modifications to the IVA proposals may be proposed by creditors. Examples of such modifications often include manipulating the percentage amounts to be paid to creditors or requiring other assets to be included in the IVA. Provided such modifications are agreed and the IVA (as modified) is approved by at least 75% of creditors (by value of their claim as admitted by the Nominee) at the creditors meeting then the IVA is accepted.

Once the IVA is accepted by creditors, no bankruptcy proceedings or other enforcement measures can be brought by any of the debtor's creditors outstanding as at the date of the IVA (e.g. seeking enforcement of a county court judgment) whilst the IVA continues. Upon completion of the IVA (including payment of the net sums due to creditors) those creditors will have no further recourse to enforce the remainder of their debt or seek any other remedy against the debtor.

WHAT HAPPENS IF A CREDITOR DOESN'T GET NOTICE OF THE MEETING?

If a creditor is not aware of a creditors meeting to propose an IVA, or the fact that the IVA has been agreed by creditors, they will still be bound by the terms of the IVA if they could have voted at the meeting (if they had received notice of the meeting). This legal provision (brought in by statute in 2000) is to prevent any unknown or overlooked creditors from ruining the IVA for the rest of the creditors.

However, if a creditor with a large claim against the debtor (such that it could have impacted on the approval of the IVA) does not receive notice or is otherwise not aware of the creditors meeting, they can apply to Court to have the meeting reinstated, the proposals modified or such other order as the Court considers appropriate. This is only worth considering if the creditor has a sufficient claim so as to change the vote and where there are no other reasons for the application to fail. This is something we can advise on.

HOW LONG DOES AN IVA LAST?

An IVA can extend over a long or short period, although it is common to find an IVA lasting for 5 years. The length of the IVA will usually depend on the way it is structured – for example if it is based on the sale of a property and the debtor has no other assets or income, it can be relatively short. Alternatively, if it is based on regular payments from a salary or business, it can take several years to conclude.

Once the IVA is concluded and the Supervisor makes a final payment to creditors, net of the payment of the associated fees and expenses, the debtor's liability to those creditors (under the IVA and generally) ceases.

WHAT HAPPENS IF A DEBTOR DOESN'T COMPLY WITH THE TERMS OF THE IVA?

If the debtor fails to comply with the terms of the IVA then under the terms of the arrangement the Supervisor will usually notify creditors of the failure. This then strips away the legal protection afforded by the IVA and leaves the debtor vulnerable to these creditors' claims as in conventional circumstances the IVA will usually cease to be enforceable against creditors. Normally an IVA will have a provision that upon the IVA failing the Supervisor must petition for the debtor's bankruptcy. However this is not always possible, especially where the debtor has not provided sufficient funds to enable the bankruptcy petition to be presented.

Importantly, an IVA does not have any effect on any new debts that arise after the date of the IVA and thus with a long-lasting IVA there is always the risk (especially where the debtor has a history of creditor problems or where the business that was intended to support the IVA does not do as well as initially assumed) that the debtor will be made bankrupt or his assets (which may or may not fall within the IVA) become subject to an interest which leapfrogs those of creditors subject to the IVA.

The IVA will usually provide for such circumstances but will not usually restrict dealings with new assets acquired by the debtor post-commencement of the IVA (e.g. residential homes).

3 Debt Relief Order ("DRO")

This is a procedure similar to a Debtor's Petition for a Bankruptcy Order and was introduced with effect from 6 April 2009. Rather than being administered by the Courts, it is administered by the Official Receiver via the Insolvency Service.

It is only available where:

- **A debtor's qualifying creditors total less than £15,000;**
- **The debtor has no personal assets to speak of (other than tools of trade and any small funds necessary for living expenses) exceeding a value of £300 (or £1,000 for a motor vehicle);**
- **The debtor has disposable income (i.e. after allowing for reasonable living expenses) of no more than £50 per month;**
- **The debtor has been a UK resident for at least three years.**

To apply for a DRO the debtor must use an “Approved Intermediary” who will examine their personal affairs and ensure they meet the statutory criterion as regards their assets, liabilities and certain other matters relating to transactions with creditors. They will then make the application on the debtor’s behalf. The Approved Intermediary will charge a fee for this service (approximately £90).

The Official Receiver may refuse the application for a DRO if the debtor or the application does not satisfy the statutory requirements or where the debtor has not answered any queries raised (although the Official Receiver must give reasons). The Official Receiver can also suspend his decision pending the response to any such queries.

Once the DRO is granted by the Official Receiver, the DRO is entered into a public register and the debtor’s stated qualifying creditors are notified of the order made. Creditors do have a right to object to the making of the DRO (or that they are in the list of creditors or any other details contained therein) within 28 days of notification. Following an investigation conducted after receiving such objections, the Official Receiver may decide to revoke or amend the DRO or apply to the Court for directions.

Upon commencement of the DRO the debtor is not immediately relieved from his/her debts. Instead, a “moratorium” commences during the course of the DRO during which creditors are unable to enforce their claims. The DRO lasts 12 months, at the end of which the debtor is discharged from his/her debts.

4 Personal administration order (“PAO”)

This is a little known procedure available for individuals. It is sometimes also referred to as a County Court Administration Order. This is a procedure whereby, upon the debtor’s application, the Court takes control of the debtor’s repayments of various liabilities, which have normally been subject to County Court Judgments (“CCJs”). It is now subject to regulations incorporated within the Court rules.

This is not used as much nowadays as the alternatives (i.e. the DRO and bankruptcy) are often preferred.

To qualify for a PAO the debtor must satisfy the following criterion:

1. **Have outstanding debts of no more than £5,000.**
2. **At least one of these debts must be a CCJ.**

The debtor will normally apply to the Court (Court form – N92) for a PAO on the basis of a payment plan. The Court fee payable upon the application cannot exceed 10% of the debtor’s liabilities. The application form must include all of the debtor’s personal details and details of assets, liabilities, income and expenditure. The Court staff can normally provide you with all of the relevant forms and assistance in this respect.

Once the application is made, the Court will have to determine the payment plan offered, whether it is reasonable and determine the payments to be made by the debtor (referred to as the “Proposed Payment Plan”).

The Court will then send notice of the Proposed Payment Plan to the debtor and notice of the application and the Proposed Payment Plan to all of his/her creditors. The debtor and creditors will have 14 days to write to the Court with details of any amendments or objections from the date of receipt of this notification. If any objections are received by the Court, the Court will list a hearing for the application and give the debtor and creditors 14 days notice of the hearing.

In the absence of any objections being received, the Court will make the PAO on the basis of the Proposed Payment Plan and monitor adherence to the order. Alternatively, the PAO may be made (or refused) at a hearing and thereafter the Court will monitor adherence to the terms of the final order made. The Court may order an employer to pay such sums directly from the debtor's earnings.

The PAO is registered in the register of CCJs and thus may affect the debtor's credit record.

If payments are not maintained, the Court may issue a warrant of execution following which a Bailiff may attend the debtor's home to remove assets by way of enforcement of the PAO. There are other criminal consequences of failing to comply with a PAO.

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