

Bankruptcy

Bankruptcy is seen as the last resort. It is perceived to be the only way to escape the ever-constant demands for payment by bill collectors and credit companies alike.

But bankruptcy is not something that should be rushed in to. Certainly there are times when it can be very useful, but there are other times when declaring bankruptcy would be a monumental mistake.

The constraints which are put upon you once you are declared bankrupt make it only a viable option in the most extreme of cases. It is more likely that an **IVA** will be the answer to severe debt problems, since it provides much of the relief offered by bankruptcy but without the severe constraints which bankruptcy imposes.

Who can become bankrupt...

- A debtor who is insolvent can be the subject of proceedings.
- A person can petition their own bankruptcy.
- Creditors can, alone or jointly, apply for a debtor to be made bankrupt where someone owes at least £750.
- Supervisor of an IVA can apply for bankruptcy proceedings against a debtor where they have defaulted.
- Only people normally resident in England or Wales are subject to bankruptcy law.

Before you make any decisions as to the suitability of declaring bankruptcy, you need to know what the Main Effects that going bankrupt will have on your current and future finances.

Main Effects of Petitioning for Bankruptcy

1. The Risk to Your Current Assets

With bankruptcy your assets (property, shares, anything of real value or even non-essential) can be sold to pay your creditors. This makes bankruptcy a more sensible option where you don't have much in the way of assets. It also means declaring bankruptcy to cope with non-priority debts puts the entire debtor's property at risk ... a strategy that would seldom be advised.

Only the property owned by the debtor is directly at risk, jointly-owned property (such as the family home) may be sold by the trustee to realise the value of the debtor's share.

Additionally, in bankruptcy the trustee can investigate any gifts or undervalued sales made in the previous five years. If the gifts or sale were made when the debtor was insolvent, the trustee can take steps to claim the value of the gift, or undervalued part of the goods, from the recipient.

2. The Risk to Your Future Assets

Where the debtor expects to receive an inheritance or already has assets, consideration should be given to any increase in value they may have whilst a bankruptcy order is in place.

Arranging matters so as to avoid losing out in such circumstances may be possible (such as amending a will) but not by transferring assets as detailed above.

3. The Effect on Your Future Credit

An undischarged bankrupt must declare his status when seeking credit of more than £500, including hire purchase and conditional sale agreements. It is an offense not to do so.

Attempting to run a business can be hampered by being an undischarged bankrupt, since credit will be nigh on impossible. Undischarged bankrupts are also forbidden from being company directors, unless they obtain special leave from the court.

Whilst utility companies cannot insist on payment of pre-bankruptcy arrears as a condition of continuing supply, they will usually require a security deposit and insist that a pre-payment meter is fitted.

4. The Effect on Your Employment or Business

There are certain jobs you cannot have if you are an undischarged bankrupt: Company Director (or concerned directly or indirectly in the management of a company), MP, Councillor, Magistrate or Estate Agent. A bankrupt usually can't be a school or college governor and there are restrictions under charity law as to the role a bankrupt can serve on management committees.

Security firms may not wish to employ an undischarged bankrupt, particularly where money is involved. And the same applies to the civil service. The rules for professions such as solicitors and accountants make it virtually impossible for people who've been bankrupted to work in these professions.

For a sole trader the effects can be even greater. Whilst bankruptcy does not necessarily mean the business will close, continuing to trade will be made more difficult:

- If the business needs credit, the requirement for the debtor to disclose that he is an undischarged bankrupt will make suppliers unlikely to provide credit;
- The bankruptcy order will be advertised locally, which could damage the reputation of the business in addition to that of its proprietor;
- The debtor cannot trade under a name other than the one under which he was made bankrupt;
- If items of business equipment are used by the debtor's employees rather than the debtor personally, exemption from sale cannot be claimed and the trustee

may order them sold. This also includes stock in trade which the trustee can sell on behalf of the bankrupt's estate.

5. The Effect on Your Housing

Homeowner or tenant, bankruptcy can still cause problems. For homeowners it can limit the ability to move to another property by reducing your ability to borrow money. It does not, however, prevent you from exchanging local authority or housing association property (providing local rules do not prohibit this).

For tenants, the inability to borrow can make it difficult to raise the deposit and/or the advance rental payments.

6. The Effect on Your Reputation and Stress

The process of declaring bankruptcy can be very stressful.

When declaring bankruptcy, it is possible that there may be a public examination of financial affairs and conduct of the debtor in open court. Though this only happens when there has been a failure to co-operate with the Official Receiver or if it is requested by 50% of the creditors.

An advertisement will be published in a local paper notifying of a person's bankruptcy and inviting claims from creditors. The details can also online at a Public Register maintained by the Insolvency Service.

For many there is still a stigma attached to declaring bankruptcy and debtors can be made to feel like criminals, though they most certainly are not.

7. Do You Have the Resources?

Just like an IVA, there are large expenses racked up when declaring bankruptcy with court and insolvency service fees applied.

Additionally, a charge of 15% will be levied on all sums received by the Official Receiver / trustee. This is paid out of the debtor's assets.

Bankruptcy Pros & Cons

There is more to bankruptcy than as a way of finally putting an end to harassing debt collectors and nagging creditors. One big side effect of bankruptcy being that your life is likely to be subjected to microscopic inspection

Bankruptcy: The Pro's

- Removes the uncertainty and stress caused by dealing with numerous creditors.
- Once an order is made, a third party takes over the administration, decision making and payment process of the debts.
- Debtors typically pay less with a bankruptcy order than with an IVA.
- Creditors forced to recognise that they must accept less money than is owed.
- Certainty that creditors cannot change their minds and that once in place, creditors take little interest in the debt.
- Once discharged, most debts are written off and creditors cannot pursue them. Some debts, such as Student Loans Company debts, are not included in bankruptcy. For those debts the bankrupt will continue to owe them even once they have completed their period of bankruptcy and have been discharged.

Bankruptcy: The Cons

- The debtor will lose any realisable assets of value. Though they may not be sold until immediately and, perhaps, not even until after the bankrupt has been discharged.
- If the debtor owns equity in a home, this will almost certainly be sold.
- If a business is owned, this could be sold and any employees dismissed.
- Should the debtor live in rented accommodation and have rent arrears, this could put the home at risk if the landlord considers those arrears are unlikely to be paid. In this case he could commence possession action. Also, some tenancy agreements contain a clause stating that an undischarged bankrupt cannot be a tenant.
- Bank current accounts can be difficult to obtain, though there are some very basic accounts offered by a limited number of banks and building societies.

- Can ultimately be expensive. All fees for the insolvency service, courts and any trustee are taken out of the debtor's assets. There is a 15% levy on all sums received by the Official Receiver/trustee.
- If trying to obtain credit of more than £500 (including ordering goods and then not paying for them on delivery) the debtor must disclose his status as an undischarged bankrupt.
- The debtor must allow all his financial affairs to be scrutinised, and can face criminal charges if irregularities are found.
- Cannot hold certain public offices, such as MP, councillor or magistrate, or practice certain professions, such as solicitor and accountant. May not hold office as a trustee of a charity or a pension fund. Nor can a bankrupt be a company director or trade under any other name than the one used at the time of bankruptcy.
- Names of those made bankrupt are published in the London Gazette and the local press and can be viewed online at the Insolvency Service website, making them accessible to anyone in the world.
- The trustee must be informed of any changes in circumstances during the bankruptcy. Once discharged from bankruptcy, the debtor's assets may still be administered by the trustee/Official Receiver.
- Certain debts cannot be written off: fines, maintenance/child support payments, other family court orders, debts to secured creditors, debts from personal injury claims, debts incurred through fraud, debt arising from certain other orders of the criminal court.
- Bankruptcy does not affect the rights of secured creditors. Where there are joint debts, creditors can still pursue the non-bankrupt debtor.
- Bankrupts found to be blameworthy, culpable or dishonest can be made subject to a Bankruptcy Restrictions Order which can impose the same bankruptcy restrictions, plus some additional ones, for anywhere from 2 to 15 years.

Petition

Both debtors and creditors can petition for the debtor to be made bankrupt under certain conditions.

The Debtor's Petition

When a debtor decides to go bankrupt he must petition the county court for the insolvency district where he/she lives (High Court in London).

The debtor must pay the court fee and deposit towards the administration of the Order, currently £150 and £325 respectively. The court has some limited powers allowing it to waive the fee, but not the deposit.

Completing the debtor's petition - Form 6.27

The petition is primarily designed with people who have been in business in mind. As these are the majority of people declaring bankruptcy.

The petition must be presented at the debtor's local court with bankruptcy jurisdiction unless the petitioner has lived and/or traded in the area of another county court for most of the previous six months. It should be noted that not all county courts have bankruptcy jurisdiction.

Completing the Statement of Affairs - Form 6.28

An extensive amount of information is required on this form, much of which may not be readily to hand. Guidance notes are supplied with the form. However, they are not comprehensive, so the following should be noted.

- **Page A**
 - Mortgage details.
 - Secured loans information.
 - Value of any property.
- **Page B**
 - All creditors should be listed in alphabetical order.
 - All unsecured debts - including joint debts - must be included.
 - Do not include any shortfall due to secured creditors, since this is covered by Page A.
- **Page C1**
 - Great care needs to be taken when completing this page.
 - Any money in bank, building society or post office accounts which is needed to live on should be withdrawn from the relevant accounts before the petition is taken to court. This money should not be included in this section.
 - Do not include the value of any equity in property listed on Page A
- **Pages C2 and C3**
 - When setting the value of any vehicle, ensure it is not set too high.
 - If the vehicle is subject to HP or conditional sale, the owner is the creditor.
 - When calculating the value of furniture and belongings, use as a guide what the items would sell for at auction. Do not use the price for the items new or the cost to replace them.
 - Any valuables listed here risk being taken.
 - Cash in hand should be entered in C3(e).
- **Page D**
 - List here any creditor who has a prior claim to goods because of any distress action already taken. The creditor will only be allowed to keep the benefit of the distress if it has been completed prior to the bankruptcy order.
- **Page E**

- This is where you enter any ongoing court action taken by creditors. Once the petition is filed at court, such actions are stayed with no further steps being taken.
- **Page F**
 - The court uses this information to decide whether an insolvency practitioner should investigate whether an IVA is more appropriate.
 - Only general attempts to make arrangements with creditors should be entered here. Not attempts to make separate arrangements with individual creditors.
- **Page G**
 - Using the information contained in the financial statement, an offer can be made if there is income available.
 - It is not necessary to make an offer if there is no income available.
 - The Official Receiver does not expect an offer if the debtor is on a low income or benefits.
 - Only regular income should be included, as well as any contributions from other members of the debtor's household.
 - Debtors are not expected to limit their expenditure to income support levels. Official Receivers tend to be more generous in the items of essential expenditure that they will allow.
 - Offers of less than £200 per month can cost more than that amount to administer and so such offers are of little benefit to creditors.

Once completed, the debtor needs to take the forms (along with the fee and deposit) to be sworn.

On receipt the court will arrange for the matter to be put before a district judge. Many cases do not result in a hearing. However, should a hearing be arranged, the debtor will be expected to attend.

At the hearing the court will refer the case to an insolvency practitioner for consideration of an IVA if:

- the debts are below £20,000
- assets are at least £2,000
- the debtor has not been subject to bankruptcy proceedings in the last five years; *and*
- it seems appropriate for an insolvency practitioner to be appointed. If the debtor does not want an IVA, then the court should be immediately informed.

If an IVA isn't applicable, the court will either:

- **Make a bankruptcy order;**
- **Dismiss the petition** - if the debtor's assets appear to exceed liabilities;
- **Adjourn the petition** - if the debts are not legally enforceable;
- **Stay the petition** - if an alternative method of dealing with the debts would be more appropriate.

If a bankruptcy order is made, the procedure that follows is similar to bankruptcy under a creditors' petition.

Creditors' Petition

If an individual creditor is owed more than £750, they can petition for the debtor to be made bankrupt. Alternatively, creditors can join together to meet the £750 requirement.

Proceedings normally take place at the debtor's local county court with bankruptcy jurisdiction. However, Crown departments (i.e. Inland Revenue, Customs & Excise) can use the High Court in London.

Creditors can only ask for someone to be made bankrupt if:

- the debt is unsecured; *and*
- for a fixed sum which the debtor 'appears unable to pay'.

The debt can be payable immediately or at some time in the future.

This can be established only by them having a Statutory Demand served or by being unable to enforce a judgment debt by means of an execution against goods by a bailiff.

For example, if a Warrant of Execution was returned unsatisfied, because the debtor did not have sufficient goods which could be seized in payment of the debt, this could be seen as evidence that the debtor 'appears unable to pay' his debts, and so the creditor could proceed to petition for the debtor's bankruptcy.

The bailiff, however, must have made serious efforts to levy execution. The bailiff simply visiting the debtor's property and reporting that he failed to gain access is not sufficient.

Statutory Demand

A statutory demand requires that the debtor either:

- Pays the relevant amount
- Offers to secure it against property
- Offers to repay the debt in a way that is satisfactory to the creditor. For example, by installments.

Some creditors use statutory demands as a way of persuading debtors to pay off the debt, usually by borrowing elsewhere.

However, statutory demands should be taken seriously. After 21 days the creditor can petition for a bankruptcy order. Therefore, it is usually worth contacting the creditor by telephone and asking them what their next step will be.

Ignoring a statutory demand may encourage the creditor to petition for bankruptcy. It is worth bearing this in mind, particularly if the debtor is contemplating petitioning for his own bankruptcy.

If the debtor wants to avoid bankruptcy he should consider:

- Making payment(s) to reduce the debt to less than £750; or
- Making an offer to pay by installments; or
- Making an offer of a reduced amount in settlement of the debt; or
- Applying to have the statutory demand set aside

Setting aside a statutory demand.

21 days after the serving of the statutory demand, the creditor can petition for the debtor's bankruptcy unless it has been 'set aside'.

An application to set aside the statutory demand can be made if:

- There is a substantial dispute about the money owed;
- There is a counterclaim of more than the money owed;
- The creditor holds security that equals or exceeds the debt in value;
- On 'Other Grounds'. Though not defined, these can include:
 - The demand was issued in error, e.g. for a secured debt or for an amount of less than £750;
 - Execution has been stayed on a judgment;
 - The debtor is complying with an installment order (so the debt is not strictly due); and
 - The creditor failed to comply with the rules and prejudiced the debtor in the process;

An application to set aside must be made with 18 days of the statutory demand being served. Forms 6.4 (application) and 6.5 (affidavit) must be completed and taken to the court. However, the court can dismiss the application if there are no grounds.

If there are grounds, a hearing will be arranged at which the court will decide whether the demand will be set aside.

If the debt falls under the Consumer Credit Act 1974, the court should also consider if any relief is available to the debtor under the Act. This would include a time order application.

Bankruptcy Order

At the hearing the court can decide one of four things:

- Dismiss the bankruptcy petition;
- Order a 'stay' in proceedings, i.e. suspend the proceedings if it feels it requires further information to make a decision;
- Consider referring the application to an Insolvency Practitioner in respect of setting up an IVA if:
 - the unsecured debts total £20,000 or less
 - assets listed in the Statement of Affairs total £2,000 or more
 - the individual petitioner has not been declared bankrupt within the last 5 years

- if the court feels that, given the circumstances, it is appropriate to do so.
- If none of the above apply, the Bankruptcy Order will be made.

If appropriate the court will also issue a Certificate of Summary Administration. One will be issued if:

- the bankrupt has unsecured debts of less than £20,000
- has neither been bankrupted or subject to a IVA in the previous 5 years
- and that the bankruptcy order is a result of a debtor's petition only.

NOTE: If the court makes no mention at the hearing of issuing a Certificate of Summary Administration, the debtor should ask the court to consider issuing one. This is because it is not possible to raise the matter at a later date.

Certificate of Summary Administration

Having a Certificate of Summary Administration simplifies the whole bankruptcy procedure and also keeps the costs down. It means that an Official Receiver will administer the bankrupt's affairs and normally proceed without investigation, although he has the power to do so.

For the debtor the most important factor of a Summary Administration is that the order will be discharged after one year and keeps the costs to a minimum.

BE WARNED. A Certificate of Summary Administration can be revoked if it is subsequently found to have been issued wrongly.

When Summary Administration is Not Applicable

When a Certificate of Summary Administration cannot be issued, e.g. when the debts exceed £20,000, the Official Receiver will decide whether a meeting of the creditors needs to be called. And if one is called, a Trustee will be appointed. A creditors' committee may also be formed to assist the Trustee.

The main difference between the Summary Administration and this procedure is that the creditors' meeting guides the Trustee. This can in turn make the whole process slower and more expensive.

If no creditors' meeting is held or Trustee appointed, then the Official Receiver will become the Trustee.

After the Bankruptcy Order is made

Once the order is made, the debtor officially becomes bankrupt and effectively loses ownership of all property / assets, except for those items excluded.

On the day of the bankruptcy order, or as soon after as possible, the debtor will be summoned to the local Official Receiver's office. It is likely the debtor will be sent form B40.01, Short Bankruptcy Preliminary Questionnaire, to complete and take to the meeting. The debtor must also make a full statement to the Official Receiver at the meeting.

The Official Receiver uses the meeting to check that there has been full disclosure of all assets and debts. Most of this information will be contained in the questionnaire. He will also investigate the conduct and affairs of the bankrupt.

An examiner from the Official Receiver's office may visit the debtor's home to complete an inspection report and remove any valuables which can be sold. Such visits are usually made to business premises, but very rarely to a debtor's home.

BE WARNED. The Official Receiver does have the power to force entry to the bankrupt's premises and have the bankrupt's mail redirected.

The Official Receiver will also look to see if the bankrupt can make any payment towards the creditors out of income, either voluntarily or as a result of an 'income payment order'. Such payments are extremely rare and are only considered if there is sufficient funds remaining after the bankrupt's domestic needs are catered for. Usually this means there has to be well in excess of £100 a month left over to make it worthwhile.

Discharge

If you were made bankrupt on or after 1 April 2004:

Then you will be automatically discharged from your bankruptcy after a maximum of 12 months.

If you were made bankrupt before 1 April 2004:

In the case of it being your first bankruptcy, you'll be discharged automatically on 1 April 2005 or if you expect your discharge date to be before 1 April 2005, you will be discharged on that earlier date.

Where someone has been an undischarged bankrupt at any time in the 15 years before the current bankruptcy, unless the previous bankruptcy was annulled, then discharge will automatically take place on 1 April 2009. You can ask the court for a discharge of 1 year after the date of the bankruptcy order, but the court can refuse or delay your discharge. Alternatively, they may grant it conditionally under certain terms, e.g. requiring that you make some payments out of income.

However, where the undischarged bankrupt has not carried out his / her duties under the bankruptcy proceedings, the Official Receiver can apply to the court to have the discharge

postponed. Should the court agree, the bankruptcy will only end once the suspension has been lifted and the time remaining on the bankruptcy period has run.

After discharge the debtor will be issued with a certificate by the court. The debtor will be released from most of the debts that were owed at the date of the bankruptcy order, with some exceptions:

- Secured creditors
- Fines
- Maintenance orders and other family court orders
- Debts from personal injury claims, unless the court thinks it fit to release you from them.
- Debts incurred through fraud
- Debt arising from certain other orders of the criminal court