



*THE
INSOLVENCY
SERVICE*

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Debts in family proceedings -

Treatment in bankruptcy

A consultation paper

May 2004



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INVESTOR IN PEOPLE

Purpose of the consultation

The Insolvency Service is considering whether to make a change to the treatment in bankruptcy of payments due under an order made in family proceedings. The purpose of this, limited, consultation is to seek information on the operation of present legislation and to explore the consequences of the suggested change in order to inform the policy-making process. This paper is being sent to those with experience of family and insolvency law, and to interest groups who represent those who would be affected by the change.

Issued May 2004

Respond by 11 August 2004

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Executive Summary

1. It has been suggested by eminent members of the judiciary and those with experience of insolvency and family law that insolvency law should be changed so that lump sum awards and costs awarded in family proceedings should be capable of being claimed in bankruptcy but that the debtor should continue to be responsible for payment of the debt, even after being released from responsibility for other debts on discharge from bankruptcy. This would benefit the spouse, who would have a dual remedy which is not available to most other creditors. Any assets in the bankruptcy would need to be divided amongst a larger pool of creditors, which would result in reduced returns to other creditors in cases where the spouse has a claim.
2. Prior to the Insolvency Act 1986, a lump sum ordered in family proceedings was a debt provable in bankruptcy, as were any costs awarded in family proceedings. The bankrupt was released from such debts on his discharge from bankruptcy. So far as periodical payments were concerned, arrears of, and future payments, were not provable and therefore not released on discharge. The position was changed in 1986 and insolvency legislation currently provides that lump sum awards and costs awarded in family proceedings are not provable and are not released on discharge. So far as periodical payments are concerned, the bankrupt remains under an obligation to make maintenance payments after his bankruptcy, including any arrears of periodical payments. (Further detail of the position before and after 1986 appears at paragraphs 18 to 20.)
3. The Insolvency Service is considering whether to make the suggested change and we would welcome your views on the proposal. We would be interested in any information you have on the operation of the present law and whether it results in significant hardship which should be addressed by making this change.
4. The proposal would extend only to England and Wales. Personal insolvency is devolved to Scotland and Northern Ireland.
5. The consultation questions, which are also listed separately at Annex A for ease of completion, are:

Q 1 Do you consider that the present provisions create a significant problem for the spouse of the bankrupt? If so, can you provide numbers of cases in which, in your experience, the present provisions have caused significant hardship and, if possible, the amounts involved?

Q 2 Do you consider that there is such a significant problem as to justify improving the position of the spouse of the bankrupt, even though that would disadvantage the other creditors?

Q 3 Do you consider that there are good grounds for putting a spouse in a better position than the other creditors by providing a dual remedy in the event of bankruptcy? If so, what are they?

Q 4 Do you consider that the change suggested would affect the balance of the interests of the bankrupt and the spouse in matrimonial proceedings? If so, how?

Q 5 Do you consider that there would be difficulties in giving the spouse a dual remedy in the bankruptcy while the family court's powers are also available to the spouse to enforce payment? If so, what difficulties?

Q 6 Do you agree that any change to the treatment of the spouse's debt in bankruptcy would need to be replicated in individual voluntary arrangements?

How to respond

6. When responding please state whether you are responding as an individual or representing the views of an organisation. If responding on behalf of an organisation, please make it clear who the organisation represents and, where applicable, how the views of members were assembled.
7. A copy of the Consultation Response form is enclosed at Annex A. An electronic version is also available at www.insolvency.gov.uk
8. A response, or any questions about the policy issues raised in the document, can be submitted to:

Katherine Parker
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The Insolvency Service
Area 5.7
21 Bloomsbury Street
London WC1B 3QW

Tel: 0207 637 6651
Fax: 0207 291 6746
Email: katherine.parker@insolvency.gsi.gov.uk

9. A list of those organisations consulted is in Annex C. We would welcome suggestions of others who may wish to be involved in this consultation process.

Additional copies

10. Further printed copies of the consultation document can be obtained from The Insolvency Service, contact details given above.

An electronic version can be found at:

www.insolvency.gov.uk/information/family.proceedings

Other versions of the document in Welsh or other languages, or audio cassette are available on request.

Confidentiality

11. Your response may be made public by The Insolvency Service. If you do not want all or part of your response or name made public, please state this clearly in the response. Any confidentiality disclaimer that may be generated by your organisation's IT system or included as a general statement in your fax cover sheet will be taken to apply only to information in your response for which confidentiality has been requested.
12. We will handle any personal data you provide appropriately in accordance with the Data Protection Act 1998.

Help with queries

13. If you have comments or complaints about the way this consultation has been conducted, these should be sent to:

Philip Martin
Consultation Co-ordinator
Department of Trade and Industry
Room 723
1 Victoria Street
London SW1H 0ET
Tel: 020 7215 5561
Philip.martin@dti.gsi.gov.uk

A copy of the Code of Practice on Consultation is in Annex B.

Introduction

14. This paper concerns a recommendation, made by eminent members of the judiciary with experience in insolvency, for a change to the way debts in family proceedings are treated in bankruptcy in England and Wales. They recommend that these debts should be provable in bankruptcy but should not be released on discharge. This change would give a spouse with such a claim against a bankrupt a dual remedy in the event of bankruptcy and therefore an advantage over the other creditors. It would also reduce the amount other creditors would recover by way of dividend in bankruptcies where the spouse has a claim.
15. Insolvency law seeks to strike a balance between the interests of the bankrupt, his or her family and the creditors. In order to assess whether it would be appropriate to affect the rights of the other creditors by changing the rights of the spouse, data is needed on the operation and impact of the current legislation, in particular to find out whether the current law results in significant hardship to spouses and, if so, the scale of the problem. The purpose of this consultation paper is to seek views to help inform consideration of the suggested change.

Rights of creditors in bankruptcy

16. Generally, a creditor's only remedy against a bankrupt is to make a claim in the bankruptcy and to participate in any distribution made by the trustee in bankruptcy from the assets realised. On discharge from bankruptcy, the bankrupt is generally released from responsibility for his debts and is enabled to make a fresh start free of his debts.
17. It has long been the case that there are very few exceptions to this rule and only limited circumstances where a creditor has the dual remedy of being able to claim in the bankruptcy but also being able to pursue the debt after discharge.¹

Rights of spouse as creditor before 1986

18. Prior to the Insolvency Act 1986, a lump sum ordered in family proceedings was a debt provable in bankruptcy, as were any costs awarded in family proceedings. The bankrupt was released from

¹ Fines imposed for an offence and debts in family proceedings are not provable and are not released on discharge. Awards for personal injuries and debts incurred by fraud are provable but are not released on discharge.

such debts on his release from discharge. So far as periodical payments were concerned, arrears of, and future payments, were not provable because the family court had the power to remit arrears or to vary those payments and they were therefore not considered to be capable of being fairly estimated for the purposes of proof in bankruptcy. Since periodical payments were not provable, the bankrupt was not released from liability on discharge.

Current rights of spouse as creditor

19. Insolvency legislation currently provides that lump sum awards and costs awarded in family proceedings² are not provable and are not released on discharge. Although the person who is the beneficiary of an order under family proceedings therefore cannot prove in the bankruptcy of the spouse, the claim can still be pursued during and after bankruptcy. However, the assets of the bankrupt which vest in the trustee will have been absorbed by the bankruptcy, leaving nothing to satisfy the divorced spouse's claim. Concern has been expressed that the impact of the change in 1986 may have reduced the rights of the spouse of a bankrupt.
20. The treatment of periodical payments for maintenance is not straightforward. The bankrupt remains under an obligation to make maintenance payments after his bankruptcy, including any arrears of periodical payments. The court can order or the bankrupt can agree to make payments for the benefit of his creditors out of disposable income for up to three years after the making of the bankruptcy order. The court must take into account money required to meet the reasonable domestic needs of the bankrupt and his family. However, the Insolvency Act 1986 defines "family" as persons who are living with him and are dependent on him, which means that maintenance payments for a spouse and children not living with him are not protected. A change to put the protection of maintenance payments beyond doubt would be desirable but would require primary legislation³ for which there is at present no vehicle. However, in practice, we consider that an order or agreement would not be made which would make it impossible for the bankrupt to continue to meet his maintenance obligations.

Suggested Change

21. It has been suggested that the law should be changed so that lump sum awards and costs awarded in family proceedings should be

² "Family proceedings" have the meaning given by section 281(8) of the Insolvency Act 1986, which applies the Magistrates' Courts Act 1980 and the Matrimonial and Family Proceedings Act 1984.

³ This could be achieved by deleting the words "are living with him and" from section 385 of the Insolvency Act 1986.

provable but should not be released on discharge from bankruptcy⁴. This could only be achieved by an amendment to the Insolvency Rules 1986. If such a change were to be made, then the treatment of such debts in bankruptcy ought to be replicated in individual voluntary arrangements.

22. It is clear that this change would benefit the spouse (and any children) since they would receive a dividend, if there are assets in the bankruptcy, as well as being able to pursue the claim after the bankrupt's discharge. However, this would be at the expense of the other creditors who would recover a lesser amount on a distribution by the trustee in bankruptcy. The creditors could include individuals or businesses whose need for the money may be just as great as the spouse but in most instances they would have no other way of recovering any further money once the bankrupt was discharged.
23. It is also possible that the suggested change would upset the balance of interests between the bankrupt and the spouse in any matrimonial proceedings. The interaction of the suggested dual remedy in bankruptcy with the wide powers of the family courts which already give the spouse an alternative remedy also needs very careful consideration.

⁴ This could be achieved by the removal of the words " under an order made in family proceedings or " from Rule 12.3(2)(a) of the Insolvency Rules 1986.

What happens next?

24. The results of the consultation will be published within two months of the close of the consultation.
25. If it is decided to make the change, we would aim to bring it into effect by 31 March 2005.

ANNEX A: CONSULTATION RESPONSE FORM

Debts arising in family proceedings
Treatment in bankruptcy

Consultation Response Form

The closing date for this consultation is 11 August 2004

The Department may, in accordance with the Code of Practice on Access to Government Information, make available, on public request, individual consultation responses. This will extend to your comments unless you inform us that you wish them to remain confidential.

Please tick if you want us to keep your response confidential

Name _____

Organisation (if applicable) _____

Address _____

Return completed forms to:

**Katherine Parker
The Insolvency Service
Policy Unit
Area 5.7
21 Bloomsbury Street
London WC1B 3QW**

Telephone: **020 7637 6651**

Fax: **020 7291 6476**

email: **katherine.parker@insolvency.gsi.gov.uk**

Respondents are asked to tick one box from the following list of options which best describes them as a respondent.

<input type="checkbox"/>	Representative Organisation
<input type="checkbox"/>	Legal practitioner
<input type="checkbox"/>	Insolvency practitioner
<input type="checkbox"/>	Interest Group
<input type="checkbox"/>	Central Government
<input type="checkbox"/>	Other (please describe):

Question 1

Do you consider that the present provisions create a significant problem for the spouse of the bankrupt? If so, can you provide numbers of cases in which, in your experience, the present provisions have caused significant hardship and, if possible, the amounts involved?

Comments:



Question 2

Do you consider that there is such a significant problem as to justify improving the position of the spouse of the bankrupt, even though that would disadvantage the other creditors?

Comments:



Question 3

Do you consider that there are good grounds for putting a spouse in a better position than the other creditors by providing a dual remedy in the event of bankruptcy? If so, what are they?

Comments:



Question 4

Do you consider that the change suggested would affect the balance of the interests of the bankrupt and the spouse in matrimonial proceedings? If so, how?

Comments:



Question 5

Do you consider that there would be difficulties in giving the spouse a dual remedy in the bankruptcy while the family court's powers are also available to the spouse to enforce payment? If so, what difficulties?

Comments:



Question 6

Do you agree that any change to the treatment of the spouse's debt in bankruptcy would need to be replicated in individual voluntary arrangements?

Comments:



Do you have any other comments that might aid the consultation process as a whole?

Please use this space for any general comments that you may have, comments on the layout of this consultation would also be welcomed.

Comments:

Thank you for taking the time to let us have your views. We do not intend to acknowledge receipt of individual responses unless you tick the box below.

Please acknowledge this reply

ANNEX B

The Consultation Code of Practice Criteria

1. Consult widely throughout the process, allowing a minimum of 12 weeks for written consultation at least once during the development of the policy.
2. Be clear about what your proposals are, who may be affected, what questions are being asked and the timescale for responses.
3. Ensure that your consultation is clear, concise and widely accessible.
4. Give feedback regarding the responses received and how the consultation process influenced the policy.
5. Monitor your department's effectiveness at consultation, including through the use of a designated consultation co-ordinator.
6. Ensure your consultation follows better regulation best practice, including carrying out a Regulatory Impact Assessment if appropriate.

The complete code is available on the Cabinet Office's web site, address <http://www.cabinet-office.gov.uk/servicefirst/index/consultation.htm>.

Comments or complaints

If you wish to comment on the conduct of this consultation or make a complaint about the way this consultation has been conducted, please write to Philip Martin, DTI Consultation Co-ordinator, Room 723, 1 Victoria Street, London SW1H 0ET or telephone him on 020 7215 6206 or email to: Philip.Martin@dti.gsi.gov.uk

Annex C: List of Individuals/Organisations Consulted

British Chambers of Commerce
Citizens' Advice
The Insolvency Court Users' Committee
Solicitors' Family Law Association
Department for Constitutional Affairs
President of the Family Division
CBI
Association of Business Recovery Professionals (R3)
Bankruptcy Advisory Service Limited
Institute of Credit Management
Family Law Bar Association
Small Business Service
Consumer Credit Counselling Service
Child Support Agency
Federation of Small Businesses
Department for Work and Pensions
Crown creditors
Rights of Women
City Women's Network
Fawcett Society
Townswoman's Guild
Women's Aid
Jewish Women's Aid
National Federation of Women's Institutes
Mothers' Union
Women's National Commission
Union of Muslim Organisations of UK and Eire
Asian Business Association
National Consumers Council
Welsh Consumers Council
Institute of Directors
Consumers Association

Annex D: Partial Regulatory Impact Assessment

TREATMENT IN BANKRUPTCY OF DEBTS ARISING OUT OF FAMILY PROCEEDINGS

Purpose and intended effect of measure

Objective

The objective would be to increase the rights of recovery of a spouse who is the beneficiary of an order in family proceedings where the person required to comply with the order is bankrupt.

The measure would enable the spouse to receive a share of any assets in the bankruptcy whilst retaining the right to seek repayment after the bankrupt has been discharged. If there were sufficient assets in the bankruptcy to make a payment to the creditors, the position of the spouse (and any children) would be improved. However, this would be at the expense of the other creditors since the assets would have to be divided amongst a larger group of creditors. The measure would also give the spouse a dual remedy which is not available to most other creditors.

This measure would only apply in England and Wales. Individual insolvency is devolved in Scotland and Northern Ireland.

Background

A debt under an order in family proceedings is at present outside any bankruptcy proceedings. This means that the spouse can continue to pursue the bankrupt for payment of the debt but cannot participate in the distribution of any assets which form part of the bankruptcy estate.

Eminent members of the judiciary with experience of insolvency have recommended the measure. We have no data to indicate whether the present provisions cause significant hardship to the spouse. One of the purposes of this consultation is to seek information about the operation of the present law in order to be able to assess whether there is a significant problem which needs to be addressed.

Options

The options are:

- retain the status quo or
- increase the rights of recovery of a spouse in bankruptcy (which can only be achieved by secondary legislation) and
- Revise guidance for proposals for individual voluntary arrangements to replicate so far as possible the revised treatment in bankruptcy.

Benefits and costs to individuals and businesses

The spouse and any children stand to gain if there are assets in the bankruptcy. There might also be a reduction in state benefits which would otherwise need to be paid.

Since the change would result in a reduction in the payments to the other creditors, who could include individuals and businesses, those creditors could themselves suffer hardship and, possibly, their own financial failure. Since debts in family proceedings at present fall outside bankruptcy, there is no reliable data on the number of instances where the bankrupt is the subject of an order in family proceedings or on the amount of the liability.

The creditors, who would be the losers if this measure were to be adopted, could include:

Mortgage lenders, if there is a shortfall on their security
Other financial institutions such as banks or credit card companies
Government departments/local authorities for unpaid taxes, overpaid benefits
Private individuals
Businesses for goods or services supplied to the bankrupt. (These are more likely to be creditors if the bankrupt was operating a business. The average number of self employed as a percentage of total bankruptcies for the three years to 2002 is 41% (2000 - 46%, 2001 - 42% and 2002 – 36%⁵)

A reduction in the amount which a trade creditor receives would have either to be absorbed by the business or passed on to its customers indirectly. At its worst, a reduced payment on account of a bad debt could cause other businesses to fail.

There is no particular business sector or size of firm which might be affected.

Issues of equity and fairness

Insolvency law seeks to strike a balance between the interests of the bankrupt, the bankrupt's family and the creditors. This measure, if adopted, would improve the position of the spouse, and any children. This would be at the expense of the other creditors, but the burden would be spread amongst a larger body of people and organisations.

Compliance costs

There would be no compliance costs for businesses in general since they would continue to submit their claim in the usual way.

⁵ Source DTI statistics. 2000 - 9952 of 21550, 2001 - 9839 of 23477, 2002 - 8854 of 24292, total for three years 28465 of 69319.

There would be an initial training cost to insolvency and legal practitioners but this would be minimal⁶. There would be no ongoing compliance costs.

Competition Assessment

There are no apparent competition implications.

Enforcement and sanctions

There would be no requirement for enforcement or sanctions.

Monitoring and review

Official receivers would be asked to provide details of any cases where the bankrupt was the subject of such an order, the amount of the claim and the effect (or likely effect) on the other creditors in the first year of the operation of the measure.

Some insolvency practitioners, and legal practitioners specialising in family law, could be asked to provide details of how much is recovered through the bankruptcy and how much by the other methods of enforcement available to the spouse.

Consultation

A list of those consulted is at Annex C.

Summary and recommendation

Proceed with a consultation to seek:

Data to indicate whether there is significant hardship which needs to be addressed by the measure

Views on whether it is fair and equitable to affect the rights of the general creditors for the benefit of the spouse.

⁶ Estimated at £950 per insolvency practitioner including an estimate for time for staff training.