Family / Insolvency

In reverse gear

Part two: Shantanu Majumdar continues to unravel the complexities of bankruptcy annulment

IN BRIEF

- In *Paulin v Paulin the Court of Appeal* examined the court's jurisdiction to reconsider its judgment before its order is sealed. However, the substantive, rather than procedural, issue for the court related to annulment of bankruptcy and the difficulties of proof which sometimes arise on such applications.

A detailed summary of the complex and sometimes colourful facts of *Paulin v Paulin* [2009] 3 All ER 88, [2009] All ER (D) 187 (Mar) appeared in the first instalment of this article (see *NLJ*, 17 July 2009, p 1015). In essence, a husband was the respondent to an application for ancillary relief by his wife and sought, by various dishonest stratagems, to disguise his assets and prevent their redistribution by the matrimonial court. The main asset was the (£1m+) proceeds of the sale of a house which had been owned by a company (Cativo Limited) put into liquidation on the basis of a sham debt designed to make it appear to be insolvent.

The husband had also been made bankrupt on his own petition. By s 272 Insolvency Act 1986 (IA 1986) the only ground upon which a debtor's petition may be presented is that he is unable to pay his debts. Section 282 provides that: "(1) The court *may* annul a bankruptcy order if it at any time appears to the court—(a) that, on the grounds existing at the time the order was made, the order ought not to have been made…" [emphasis added].

The wife therefore had to show that the husband had in fact been able to pay his debts at the time of the order but, even if so satisfied, the court has a discretion whether the bankruptcy should now be annulled; there are thus two stages.

Abuse of process

Much of the debate before the Court of Appeal in *Paulin* concerned the question whether a bankruptcy could be annulled on the separate ground that the petition was an abuse of the court's process ie even if the debtor had indeed been unable to pay his debts at the time of his petition.

In principle, abuse of process is an available ground: R 7.51 of the Insolvency Rules 1986 applies the CPR and the practice and procedure of the courts to insolvency proceedings unless they are inconsistent with the Insolvency Rules and there is no such inconsistency with CPR 3.4(2) which provides that: "(2) The court may strike out a statement of case if it appears to the court; (b) that the statement of case is an abuse of the court's process…"

> **"Generally speaking if the debtor was unable to pay his debts on the date of his petition then its presentation was not an abuse of process"**

However, the authorities in which abuse of process had been found were cases in which the abuse was the very fact that the debtor had been able to pay his debts and in *Re Holliday* [1981] Ch 405 the question whether even though the debtor could not pay his debts his petition could still be an abuse of process because of his foul motive was not resolved. The sole case which seemed to support that proposition was in *Re Betts, Ex parte Official Receiver* [1901] 2 KB 39 but this related to a "professional bankrupt" and the court in *Paulin* preferred to proceed on the basis that that had been an extreme case and, therefore, that generally speaking if the debtor was unable to pay his debts on the date of his petition then its presentation was not an abuse of the process of the court.

Insolvency and the burden of proof

The test of ability to pay debts is one of "commercial" (rather than 'balance sheet') insolvency", *viz* whether he could meet his liabilities and in *Re Coney (A Bankrupt)* [1998] BPIR 333 David Oliver QC said that: "...it would not normally be right...to annul a bankruptcy order unless at least it is shown that as at the date of the order the debtor was in fact able to pay his debts, or had some tangible and immediate prospect of being so able which has since been fulfilled or would so have been but for the order itself. It is with regard to a 'tangible and immediate prospect' that the assets and liabilities of a debtor and their nature will usually be of relevance."

Sandwell v Porter

In *Sandwell v Porter* (1966) 115 CLR

666 the High Court of Australia explored the boundaries of the concept of the debtor's assets: "But the debtor's own moneys are not limited to his cash resources immediately available. They extend to moneys which he can procure by realization by sale or by mortgage or pledge of his assets within a relatively short time—relative to the nature and amount of the debts and to the circumstances, including the nature of the business, of the debtor." *Per* Barwick CJ at 670.

Balance of probabilities

The burden of proof that the bankrupt was able to pay his debts on the date of the order lies upon the applicant for annulment and the standard is the normal civil balance of probabilities uncomplicated by the—discredited—notion of a sliding scale based on the gravity of any allegation of impropriety (*see in Re B (Children) (Care Proceedings: Standard of Proof) (CAFCASS intervening)* [2008] UKHL 35, [2009 1 AC 11, [2008] All ER (D) 134 (Jun)).

In *Paulin* it was held that where the applicant for annulment of a bankruptcy order made on a debtor's petition establishes that there was no balance sheet insolvency, *ie* that his assets exceeded his liabilities, the evidential onus shifts to the debtor to establish commercial insolvency, *ie* that nevertheless he was unable to pay his debts. The existence of commercial insolvency in such a situation plainly requires an explanation and that explanation and the evidence to support it will lie more obviously in the hands of the bankrupt than the applicant.

The court was also assisted by two authorities both from a family context but plainly of wider application in the sphere of bankruptcy.

- The first was *Newton v Newton* [1990] 1 FLR 33 where the husband had substantial assets but the wife's evidence of his ability to raise the lump sum which she had been awarded at first instance had been rather slender. The Court of Appeal held that absence of evidence as to his bankers' probable or actual reaction to an application for a loan was a "glaring lacuna" which had justified the judge in taking the view that it was for the husband to lead evidence to show that he could *not* raise the money.
- The second case was *F v F (Divorce: Insolvency: Annulment of Bankruptcy Order)* [1994] 1 FLR 359 on the approach of the court where the evidence in support of the debtor's petition is less than full and frank. In ancillary relief proceedings, adverse inferences are drawn against parties whose evidence is similarly deficient and in *Artman v Artman* [1996] BPIR 511 that principle was applied in annulment applications in the making of presumptions against "a debtor who prevaricates and fails to give a candid account of his affairs". *Phipson on Evidence* opines that a rebuttable presumption is not the same thing as a shift of the evidential burden but as Wilson LJ so elegantly put it in *Paulin* "if not identical twins, the two concepts are surely first cousins."

On the facts of *Paulin* it was clear that the husband had attracted the evidential burden of showing that he could not pay his debts. He had made a substantially dishonest Statement of Affairs in which he had claimed *inter alia* that he had no interest in any freehold property, that he owned no property abroad and no shares and that he was living in the property owned by Cativo for a nominal rent.

Findings

On the judge's findings these statements were quite untrue and the Court of Appeal was satisfied that the husband had neither discharged the evidential burden nor rebutted the presumption which arose against him. The judge had concluded that as at the time of the bankruptcy order the court would have varied the freezing order or that the husband could have obtained bridging finance in either case for the purpose of discharging his (genuine) debts. The Court of Appeal was rather sceptical about the second possibility but as to the first it decided that any uncertainty which it might have felt about the reaction of the court to the husband applying for a relaxation of the freezing injunction only arose because of his dishonest case in the court below that the assets in question were not his. If, instead, there had been an honest presentation of his affairs then the court would have been likely to co-operate.

Discretion

Finally, the question of discretion arose. In *Artman v Artman* it was said that: "The statute does not lay down any particular matters to be taken into account in the exercise of the court's discretion, but the likely effect of any annulment order on the applicant, on the bankrupt where he is not the applicant, and on the bankrupt's other creditors must, it seems to me, be among the most important matters to be taken into account. So must any element of abuse of process in the obtaining … of the bankruptcy order." (*Per* Robert Walker J at 514B).

Powerful reasons

The husband's nefarious motive for presenting his petition and the effect on the wife's ancillary relief application of refusing to annul the bankruptcy were powerful reasons for exercising the discretion to annul but the judge had expressed the view that the annulment of the husband's bankruptcy would have been "idle" because the husband's creditors would then quickly petition for him to be made bankrupt again. The Court of Appeal disagreed; it would not be an idle exercise of the discretion if to do so would have enabled the judge to make the capital provision sought by the wife in her application for ancillary relief and to the extent that the judge may have thought that he could not do so because such an order would be at risk of being set aside as a transaction at an undervalue in any subsequent bankruptcy proceedings, then this fear was simply not justified in the light of the decision of the Court of Appeal in *Hill v Haines* [2007] EWCA Civ 1284, [2008] 1 FLR 1192, [2008] 2 All ER 901.

Even so, the interests of the husband's genuine creditors were still relevant to the exercise of the discretion but quite apart from the fact that the wife seemed to have issued proceedings before the creditors had done so, where resources are scarce the family court will not always be able to make an order which allowed the husband to discharge his liabilities and it follows that in such situations the interests of creditors do not necessarily outweigh those of the wife. Accordingly, the judge had exercised his discretion correctly. NLJ

Shantanu Majumdar is a barrister practising at Radcliffe Chambers in Lincoln's Inn and appeared for the joint liquidators in *Paulin v Paulin*, instructed by Francis Wilks & Jones LLP. E-mail: *SMajumdar@radcliffechambers.com*