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Insolvency judge declares divorce consent order signed by bankrupt husband void

*Ian Robert [Trustee in bankruptcy of Jonathan Elichaooff
(deceased)] v. Sarah Woodall
[2016] EWHC 2987 (Ch)*

Article by David Bowden

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Executive speed read summary

An insolvency court has had to rule on what happens where there is an overlap between the provisions in the Insolvency Act 1986 and the Matrimonial Causes Act 1973. Between the date a consent order in divorce proceedings was signed by the husband and the date it was sealed by the family county court, the husband was made bankrupt and later died. 6 years later his trustee in bankruptcy made a number of applications against the wife. The trustee's application seeking an order that the ancillary relief consent order in the divorce proceedings was void was granted by Mr Registrar Jones.

The trustee made a more ambitious order for a property adjustment order against the wife under the MCA. This application was dismissed as the court followed a long line of authority that such applications abate on the death of one spouse. The wife also submitted that only a family court could be seized of such an application. The trustee sought to recover £40,000 paid by the bankrupt to his wife before his death on the basis that these were void as a transaction at an undervalue under s339 of IA 1986. This application was struck out by the Registrar but an application for permission to appeal this was granted by Morgan J. At an oral reconsideration hearing, the deputy judge agreed that this order was properly made and this issue can go forward on appeal.

Finally, the registrar made an adverse costs order against the trustee ordering him to pay 75% of the costs even though he was successful on one issue. Morgan J granted permission to appeal this order and the wife's attempt to challenge this was unsuccessful. The case will now proceed as an appeal to a judge of the chancery division who will determine if the £40k was a transaction at an undervalue or not and whether the 75% adverse costs order should be set aside or varied.

Ian Robert [Trustee in bankruptcy of Jonathan Elichaooff (deceased)] v. Sarah Woodall
[2016] EWHC 2987 (Ch) 25 November 2016
High Court of Justice, Chancery Division (Deputy Judge Robin Dicker QC)

What are the facts?

Mr Elichaooff ('the debtor') and Ms Woodall ('the wife') married in 1999 and a divorce petition was presented in 2008. A bankruptcy petition was presented against debtor in March 2009 and a bankruptcy order was made on 7 July 2009. On 5 June 2009 the terms of a consent order between the bankrupt and the wife in relation to periodical payments and a property adjustment order were agreed but this order was not sealed by the Kingston County Court until 16 July 2009 – 9 days after the husband was declared bankrupt. The bankrupt had issues with drug addiction and committed suicide in November 2014. Some payments had been made by the bankrupt to the wife which his trustee in bankruptcy sought to recover as being either transactions at an under value or a preference under the Insolvency Act 1986 ('IA 1986').

What does the Insolvency Act 1986 say?

Section 283(1)(a) of IA 1986 defines a bankrupt's estate as '*all property belonging to or vested in the bankrupt at the commencement of the bankruptcy*'. Section 284 of IA 1986 deals with 'Restrictions on dispositions of property' and provides:

- '(1) Where a person is adjudged bankrupt, any disposition of property made by that person in the period to which this section applies is void except to the extent that it is or was made with the consent of the court, or is or was subsequently ratified by the court.*
- (2) Subsection (1) applies to a payment (whether in cash or otherwise) as it applies to a disposition of property and, accordingly, where any payment is void by virtue of that subsection, the person paid shall hold the sum paid for the bankrupt as part of his estate.*
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- (6) A disposition of property is void under this section notwithstanding that the property is not or, as the case may be, would not be comprised in the bankrupt's estate; but nothing in this section affects any disposition made by a person of property held by him on trust for any other person.'*

As to transactions at an undervalue, section 339 states:

- '(1) Subject as follows in this section and sections 341 and 342, where an individual is adjudged bankrupt and he has at a relevant time (defined in section 341) entered into a transaction with any person at an undervalue, the trustee of the bankrupt's estate may apply to the court for an order under this section.*
- (2) The court shall, on such an application, make such order as it thinks fit for restoring the position to what it would have been if that individual had not entered into that transaction.*
- (3) For the purposes of this section and sections 341 and 342, an individual enters into a transaction with a person at an undervalue if—*

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Ian Robert [Trustee in bankruptcy of Jonathan Elichaooff (deceased)] v. Sarah Woodall [2016] EWHC 2987 (Ch)

(a) he makes a gift to that person or he otherwise enters into a transaction with that person on terms that provide for him to receive no consideration,

...

(c) he enters into a transaction with that person for a consideration the value of which, in money or money's worth, is significantly less than the value, in money or money's worth, of the consideration provided by the individual.'

Finally section 340 on preferences provides:

'(1) Subject as follows in this and the next two sections, where an individual is adjudged bankrupt and he has at a relevant time (defined in section 341) given a preference to any person, the trustee of the bankrupt's estate may apply to the court for an order under this section.

(2) The court shall, on such an application, make such order as it thinks fit for restoring the position to what it would have been if that individual had not given that preference.

(3) For the purposes of this and the next two sections, an individual gives a preference to a person if—

(a) that person is one of the individual's creditors or a surety or guarantor for any of his debts or other liabilities, and

(b) the individual does anything or suffers anything to be done which (in either case) has the effect of putting that person into a position which, in the event of the individual's bankruptcy, will be better than the position he would have been in if that thing had not been done.

....

(6) The fact that something has been done in pursuance of the order of a court does not, without more, prevent the doing or suffering of that thing from constituting the giving of a preference.'

What does the Matrimonial Causes Act 1973 say?

Section 23 of the Matrimonial Causes Act 1973 ('MCA') deals with 'financial provision orders in connection with divorce proceedings' and s23(1) provides that:

'(1) On granting a decree of divorce, ... or at any time thereafter ... the court may make any one or more of the following orders, that is to say—

(a) an order that either party to the marriage shall make to the other such periodical payments, for such term, as may be specified in the order;

(b) an order that either party to the marriage shall secure to the other to the satisfaction of the court such periodical payments, for such term, as may be so specified;

(c) an order that either party to the marriage shall pay to the other such lump sum or sums as may be so specified'

Section 24 of the MCA deals with 'Property adjustment orders' and provides that:

'(1) On granting a decree of divorce, ... or at any time thereafter ... the court may make any one or more of the following orders, that is to say—

(a) an order that a party to the marriage shall transfer to the other party, ... such property as may be so specified, being property to which the first-mentioned party is entitled, either in possession or reversion'

Section 25 of the MCA deals with matters to which court is to have regard in deciding how to exercise its powers under sections 23 and 24, providing in particular that:

'(2) As regards the exercise of the powers of the court under section 23(1)(a), (b) or (c), 24, 24A or 24B above in relation to a party to the marriage, the court shall in particular have regard to the following matters—

(a) the income, earning capacity, property and other financial resources which each of the parties to the marriage has or is likely to have in the foreseeable future, including in the case of earning capacity any increase in that capacity which it would in the opinion of the court be reasonable to expect a party to the marriage to take steps to acquire;

(b) the financial needs, obligations and responsibilities which each of the parties to the marriage has or is likely to have in the foreseeable future'

Finally section 27(6) of the MCA on financial provision orders states:

'(6) Where on an application under this section the applicant satisfies the court of any ground mentioned in subsection (1) above, the court may make any one or more of the following orders, that is to say—

(a) an order that the respondent shall make to the applicant such periodical payments, for such term, as may be specified in the order;

(b) an order that the respondent shall secure to the applicant, to the satisfaction of the court, such periodical payments, for such term, as may be so specified;

(c) an order that the respondent shall pay to the applicant such lump sum as may be so specified'.

What happened on Mr Elichaooff's insolvency?

Following the making of the bankruptcy order, the official receiver initially dealt with his affairs.

Subsequently Mr Robert was appointed his trustee in bankruptcy.

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Ian Robert [Trustee in bankruptcy of Jonathan Elichaff (deceased)] v. Sarah Woodall [2016] EWHC 2987 (Ch)

Were any payments made by or to the former wife?

Payments amounting to £40,000 were made by the bankrupt to the wife in November and December 2008. The statutory demand was not served on the bankrupt until afterwards. In a telephone interview with the official receiver, the bankrupt also said that he had borrowed approximately £1.4million from his ex-wife but that there was no written agreement about it.

What application did the trustee in bankruptcy issue?

On 6 July 2016 the trustee issued an ambitious application in the bankruptcy court (rather than in the county court that made the MCA orders) seeking these 3 things:

- A declaration that the consent order signed by the bankrupt on 5 June 2009 in his divorce proceedings was void,
- An order against the wife for a property adjustment order under sections 23 and 24 of the MCA, and
- A declaration that payments of £40k made by the bankrupt to the wife were either transactions at an undervalue or voidable preferences under sections 339 and 340 of IA 1986.

What happened to the trustee's application when it was heard by Mr Registrar Jones?

The trustee's application was heard by Mr Registrar Jones on 23 February 2016. In his unreported reserved judgment dated 15 March 2016, he granted the trustee only some of what he sought. The Registrar declared that all dispositions of property by the bankrupt under the consent order in his divorce proceedings '*were void pursuant to s284 of the 1986 Act*'.

However the Registrar also:

- Dismissed the trustee's application for a lump sum or property adjustment order under sections 23/24 of the MCA,
- Struck out the trustee's application for a declaration that the transfer of £40k by the bankrupt to his wife was a transaction at an undervalue, and
- Ordered the trustee to pay three-quarters of the wife's costs.

What happened when the case came before Mr Justice Morgan?

The Trustee sought permission to appeal the order made by Mr Registrar Jones. That application was determined on the papers by Mr Justice Morgan on 20 June 2016. Morgan J refused the trustee permission to appeal the order in relation to section 23/24 of the MCA but granted the trustee permission to appeal on these 2 points:

- The order striking out the trustee's claim that the £40k payments were transactions at an undervalue under IA s339, and
- The adverse costs order made against the trustee.

What were the applications before Deputy Judge Robin Dicker QC?

There were 2 applications before the Deputy Judge. The first was an application by the trustee seeking to renew his application for permission to appeal the MCA s23/24 issue that Morgan J had refused on the papers. The second, was an application by the wife seeking to set aside the order made by Morgan J whereby he granted the trustee permission to appeal the transaction at an undervalue issue.

What were the 3 issues that Deputy Judge Robin Dicker QC was required to rule on?

The Deputy Judge had to determine these 3 issues:

- Could the trustee sustain an application against the wife under sections 23/24 of the MCA?
- Was the £40k payment by the bankrupt to the wife a transaction at an undervalue under s339 IA?
- Was the adverse costs order made by the Registrar properly made?

What had the Court of Appeal previously decided in *Harb v. King Fahd bin Abdul Aziz*?

In this appeal [2005] EWCA Civ 1324 the wife made an application for financial provision but prior to the hearing of the appeal, her husband died. The Court of Appeal ordered that there be no further order made on the wife's appeal with Dyson LJ ruling that s27(6) of the MCA '*enabled the court to make orders against the other party to a marriage during joint lives only*'. It also ruled that applications for financial relief under the MCA are not applications in respect of a cause of action under s1 of the Law Reform (Miscellaneous Provisions) Act 1934. Thorpe LJ ruled that where a spouse has obtained a secured provision order during their joint lives, the MCA does not mean that it does not continue to benefit that spouse after the death of the other. Finally Dyson LJ ruled that an application for financial relief by one party to a marriage against another abates on the death of the other.

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Ian Robert [Trustee in bankruptcy of Jonathan Elichhoff (deceased)] v. Sarah Woodall [2016] EWHC 2987 (Ch)

Are there any other prior authorities of relevance?

These authorities are relevant in this case:

D'Este v. D'Este [1973] Fam 55 (Ormrod J)

The matrimonial causes legislation is a personal jurisdiction arising between the parties to a marriage of their children. Any applications made under this legislation abates on the death of one spouse.

Platt v. Platt [1976] 170 SJ 199 (Court of Appeal – Pennycuik LJ)

A judge was not told a bankruptcy notice had been given to the husband who was later adjudicated bankrupt. The judge refused to set aside the MCA orders made between the 2 former spouses because the issue in matrimonial proceedings lay between the husband and wife and any other creditors would not be entitled to be present. A divorce judge is only concerned to do what is right between the 2 spouses and is not concerned to weigh the interest of the wife and her ex-husbands creditors.

Barings Bank plc v. Coopers & Lybrand [2002] EWCA Civ 1155 (Court of Appeal – Jonathan Parker & Laws LJ)

The power under CPR part 52.9 is not a power to entertain an appeal against the grant of permission to appeal. Its purpose is to do justice in rare cases where something in the nature of an irregularity has occurred in the granting of permission to appeal.

What ruling did Deputy Judge Robin Dicker QC give on the trustee's claim for a property adjustment order against the wife under the MCA?

The deputy judge agreed that both Morgan J and Mr Registrar Jones were correct in their reasoning and refused permission to appeal to the trustee.

The deputy judge said he had to confess to *'some initial surprise at the suggestion that a trustee in bankruptcy is entitled after the death of the bankrupt to apply for an order for financial relief against the surviving party to the marriage for the benefit of the bankrupt's creditors'* and that his initial reaction *'was only reinforced during the course of the trustee's counsel's submissions'*. He referred to *Harb* and noted that the MCA was a consolidating act which had to be interpreted against the background of previous statutes which *'had been consistently interpreted as meaning'* that applications for financial relief *'cease when one of them died'*. This was also clear from the Law Commission's 2nd report on family property (1974) **Law Comm No 61**.

The deputy judge rejected the trustee's submissions that there was a material difference to the wording of sections 23/24 to s27 of the MCA which could open the door to such an application saying that this distinction *'cannot bear the weight he seeks to put on it'*. The deputy judge branded as *'misconceived'* the trustee's submission that a bankrupt still had *'obligations'* after his death which a court could take into account in determining a MCA application.

The deputy judge agreed with Morgan J that rights of a spouse under s23/24 of the MCA were not causes of action at all and he ruled that this was fatal to the trustee's application because the trustee needed to show that the MCA claim was a *'cause of action'* which is *'one that is still capable of being pursued after one of the parties had died'*. He drew further support from this from both a technical manual issued by the Insolvency Service and the text in *Muir Hunter on Personal Insolvency*.

Concluding on the MCA issue, the deputy judge ruled that *'the Registrar was correct to have struck out the claim on the basis that the Trustee had no real prospect of obtaining the relief sought'* and also that Morgan J was correct in refusing permission to appeal.

What ruling did the Deputy Judge give on the trustee's claim that the £40k payment by the bankrupt to the wife was a transaction at an undervalue?

The order of Morgan J granting permission to appeal on this issue will stand and this will go forward to appeal in due course.

As a preliminary issue, the deputy judge said that applications for *'reconsideration of an order giving permission to appeal are not lightly to be made'*. However the wife's counsel submitted that the trustee's application for permission to appeal *'had been made on the basis of seriously incomplete and misleading information'* and submitted that her application was this *'proportionate and consistent with the over-riding objective'*. Without expressly ruling on the issue, the deputy judge nevertheless considered this issue.

Registrar Jones struck out the IA s339 claim on the basis that the payments had been made by way of loan by the bankrupt. Registrar Jones ruled that:

Insolvency judge declares divorce consent order signed by bankrupt husband void
Ian Robert [Trustee in bankruptcy of Jonathan Elichaoﬀ (deceased)] v. Sarah Woodall [2016] EWHC 2987 (Ch)

'I have found no explanation in the evidence for why the financial information provided by Ms Woodall has not been accepted. On its face it establishes a running account of loans to Mr Elichaoﬀ and repayments by him when he was able to do so. That being so, the last 5 re-payments cannot be treated as lacking consideration. I do not understand how it can be suggested otherwise and absent any explanation in the evidence to the contrary, the application to strike-out succeeds in respect of the claim under section 339 IA'.

Morgan J when considering the trustee's permission to appeal application on the papers ruled that *'it was reasonably arguable that the Registrar should not have struck out that claim'*.

In the application for permission was a file note recording a telephone interview between the bankrupt and the official receiver in which he said he had borrowed £1.4m from his wife and that payments were not really loans. The deputy judge did not consider that Morgan J had been misled on the paper application for permission and ruled that he *'did not consider'* that Morgan J's order *'should be set aside on these grounds'*. He ruled that the *'critical point was that the Bankrupt had made a comment about the nature of the payments which, on one construction, was capable of throwing doubt on the nature of the payments, but which, for whatever reason, the Registrar did not expressly deal with in his judgment.'*

Although the deputy judge said it would have been *'appropriate for those acting for the Trustee'* to have drawn Registrar Jones' attention to the official receiver's file note when his draft judgment was circulated, he nevertheless did *'not consider that this omission should lead to the order for permission being set aside'*.

What ruling did the Deputy Judge give on Registrar Jones adverse costs order against the trustee?

The deputy judge ruled that in his judgement there was nothing in the points made by the wife's counsel *'which leads to the conclusion that Morgan J was misled, such that his order granting permission to appeal should be set aside'*.

The trustee submitted that he was successful on his application seeking a declaration that the divorce consent order was void and that the starting point is that he should be awarded his costs on that issue, with the wife having an order for her costs on the other issue. The trustee submitted that Registrar Jones order that the trustee should pay three-quarters of the costs was wrong in principle. The wife submitted that the trustee had not been entirely successful and the trustee had been unsuccessful in setting aside the claim for repayment of the £1.4million loan.

What will happen next?

As Morgan J granted the trustee permission to appeal on 2 issues, this will now be listed in due course for an appeal by a judge or deputy judge of the chancery division of the High Court. This appeal will be limited to 2 narrow issues, namely whether:

- the £40k payment by the bankrupt was a transaction at an undervalue, and
- the 75% adverse costs order against the trustee should be set aside or varied.

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David Bowden is a solicitor-advocate and runs David Bowden Law which is authorised and regulated by the Bar Standards Board to provide legal services and conduct litigation. He is the cases editor for the Encyclopedia of Consumer Credit Law. If you need advice or assistance in relation to consumer credit, financial services or litigation he can be contacted at info@DavidBowdenLaw.com or by telephone on (01462) 431444.
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