

Bankruptcy

a guide for unsecured creditors



Bankruptcy

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A licensed insolvency practitioner has given you this because you, or your business, may be owed money by a private individual or a sole trader who has become bankrupt.

This guide aims to help you understand your rights as a creditor and to describe how best these rights can be exercised. It is intended to relate only to England and Wales. It is not an exhaustive statement of the relevant law or a substitute for specific professional or legal advice.

We have made every effort to ensure that the guide is accurate, but R3 cannot accept responsibility for the consequences of any action you take in reliance on its contents. If, having read the guide, you remain in any doubt about your rights, you should consult a licensed insolvency practitioner or a solicitor.

Depending on the circumstances of the case, creditors who play an active role in an insolvency can make a significant difference to how much the insolvency practitioner will be able to recover for them. We hope that you will read this guide carefully and consider whether taking an active role as a creditor in this case could benefit you or your business.

Who can be made bankrupt?

Only individuals can be made bankrupt. Bankruptcy does not apply to companies or partnerships, although individual members of a partnership can be made bankrupt.

How is an individual made bankrupt?

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The debtor, one or more of his creditors or the supervisor of a voluntary arrangement, amongst others, may present a bankruptcy petition.

The purpose of the bankruptcy order is to appoint a responsible person who has a duty to collect the bankrupt's assets and distribute them to his creditors in accordance with the law.

Who is appointed to deal with the bankrupt's estate?

Once a bankruptcy order is made, the court will usually appoint the Official Receiver to administer a bankrupt's estate. The Official Receiver is a civil servant and an officer of the court. The Official Receiver must then decide within twelve weeks of the bankruptcy order whether to call a meeting of creditors to appoint a licensed insolvency practitioner to act as trustee in bankruptcy (trustee). In certain circumstances the Department of Trade & Industry (DTI) or the court may make such an appointment.

This guide assumes that a licensed insolvency practitioner has been appointed trustee.

What is the effect of the bankruptcy order on the individual?

The bankrupt's property vests in the trustee. The bankrupt loses any rights to his property apart from any equipment needed by him for use in his business, and basic domestic equipment such as clothes, bedding and furniture, and certain pension rights.

Generally, if the bankrupt has equity in a house, it may have to be sold

There are special rules regarding the bankrupt's home. Generally speaking, if the bankrupt has equity in a house, it may have to be sold. However, the law discourages a trustee from taking steps to force a sale through the court during the first 12 months of the bankruptcy where the bankrupt is married or has young children living with him. The trustee has three years from the date of the bankruptcy order to sell the house or otherwise deal with the bankrupt's interest in it. If he does not do so within that time, the property will revert to the bankrupt. And if the value of the equity is less than £1,000 the trustee will not be able to sell it at all.

If the bankrupt has surplus income above his needs and those of his dependants, he may be required to make contributions to his creditors for up to three years.

The trustee may also claim any property acquired by the bankrupt after the bankruptcy order, such as assets left to him in a will.

The bankrupt can carry on in business but with the following restrictions:

- The bankrupt must not obtain credit of more than £500 from anyone without telling that person that he is an undischarged bankrupt.
- The bankrupt must not carry on business under a name different from that under which he was declared bankrupt without disclosing the fact that he is an undischarged bankrupt.
- The bankrupt must not act as a director of a company or be involved in its management without the court's consent.

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What are the powers of the trustee?

The trustee's powers are wide and include powers to sell the bankrupt's assets, to carry on the bankrupt's business, to bring and defend legal proceedings, and to pay dividends to the bankrupt's creditors. He also has wide investigatory powers. Some of the trustee's powers can only be exercised with the agreement of the creditors' committee (or if none the DTI) or the court.

Does the trustee pay unsecured creditors the money owed to them?

Secured and preferential creditors' debts are paid before unsecured creditors. Secured creditors are those that have some form of security over a bankrupt's property (for instance a building society where a bankrupt has a mortgage). Secured creditors are entitled to be repaid their debt out of the proceeds of sale of the secured asset in priority to other creditors.

Preferential creditors are a special category of unsecured creditor. They consist mainly of certain debts due to employees and the Redundancy Payments Service and are paid in priority to all other unsecured creditors.

The trustee will pay a dividend to unsecured creditors if enough funds have been realised from the bankrupt's assets after paying costs, secured creditors and preferential creditors.

When all claims have been adjudicated or provided for, the trustee will declare a dividend. The dividend will be a percentage (pence in the pound) of each creditor's total admitted claim, based on the total cash available for distribution to the creditors and the total of all creditors' claims. All unsecured creditors are treated equally.

Six months after writing off the debt in your accounts you can claim Bad Debt Relief from HM Customs and Excise for VAT you have paid.

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How do I make a claim in the bankruptcy?

The trustee will write to all known creditors asking them to submit their claims. You should submit your claim to the trustee in writing within the specified time limit. You should also send enough supporting evidence of your claim, e.g. copy statements, invoices, correspondence etc. to allow the trustee to decide whether or not your claim is valid. The trustee will not necessarily acknowledge receipt of your claim, but will advise you when he has adjudicated your claim. Any costs incurred in submitting your claim will not be reimbursed.

You may claim interest on your outstanding debt up to the date of the bankruptcy order if your debt bore interest, if it was payable at a previous date under a written instrument, or if you had previously demanded it in writing with notice that you would claim interest. You will not get interest on your claim accruing after the date of the bankruptcy order unless all creditors can be paid in full.

If you believe that you own something in the bankrupt's possession, you should contact the trustee as soon as possible with full proof of ownership and be prepared to identify what you are claiming. The trustee will examine your claim carefully before deciding whether to release the goods in question, pay you for them, or otherwise.

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How will the trustee adjudicate my claim?

The trustee will consider your claim and any supporting information. He will compare your claim to the bankrupt's records and any other available information, and may discuss the claim with the bankrupt. The trustee may ask you for additional information or evidence if he thinks you have not sufficiently proved your claim. For example, if you have supplied goods to the bankrupt, the trustee may ask you to provide copies of signed delivery notes.

The trustee may agree your claim in full, or in part, or he may reject your claim if he does not think it is valid.

What can I do if I believe the trustee has unfairly rejected my claim?

You should first discuss the matter with the trustee. If you cannot reach agreement you can, within 21 days of rejection, appeal to court. After 21 days, if you do not apply to the court, the adjudication is final.

Does the trustee have to fulfil contracts entered into by the bankrupt prior to his appointment?

A trustee has a general duty to maximise the level of dividend to creditors. The trustee may decide not to fulfil a contract if it does not benefit

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creditors as a whole. If the trustee chooses not to fulfil a contract, the other party may have an unsecured claim in the bankruptcy for breach of contract.

Is the trustee liable for sums due under contracts entered into by the bankrupt after the bankruptcy?

No. The bankrupt can continue to trade after the bankruptcy order (with the conditions noted above). Any new debts created cannot be claimed in the bankruptcy.

As an unsecured creditor, what information am I entitled to?

The Official Receiver must send at least one report to creditors after his appointment. This will usually contain a statement of affairs completed by the bankrupt showing details of his assets and liabilities.

The trustee has no duty to report to creditors on the progress of the bankruptcy until the bankruptcy is complete or until he plans to pay a dividend. The trustee may call meetings of creditors or send written reports to creditors if there are any major developments in the bankruptcy. If you would like information on progress at any time you should contact the trustee.

You may also require the trustee to hold a meeting of creditors if you have the support of 10% of creditors (by value of debt).

When the bankruptcy has been completed, the trustee will call a final meeting of creditors and present a report on the bankruptcy.

How can I help the trustee to achieve the best possible outcome for creditors?

The unsecured creditors can form a creditors' committee to help the trustee (see below). You should also tell the trustee if you believe the bankrupt has assets, income or business interests he has not disclosed, or if you think you have any information that might be useful to the trustee.

Can the unsecured creditors form a creditors' committee?

Yes. A creditors' committee may be appointed at a meeting of creditors and must consist of at least three and not more than five creditors.

The creditors' committee receives reports from the trustee and may meet periodically. It assists the trustee, approves his remuneration and sanctions the exercise of certain of his powers.

Creditors' committee members are not paid, but will receive their reasonable travelling expenses as a cost of the bankruptcy.

How is the trustee's fee determined?

The creditors' committee (if there is one) or the creditors agree the trustee's fee, failing which it will be determined in accordance with a statutory scale or fixed by the court. The fee can be fixed as a

percentage of the assets realised or distributed (or both), or by reference to:

- the time properly spent by the trustee and his staff;
- the complexity of the case;
- any exceptional responsibility borne by the trustee;
- the effectiveness with which the trustee carries out his duties; and
- the value and nature of the bankrupt's assets.

R3 has produced a separate guide explaining insolvency office holders' remuneration, which is available from the person who gave you this guide.

When will the bankrupt be discharged from bankruptcy?

The bankrupt will usually be discharged from bankruptcy automatically after one year, or sooner if the Official Receiver decides to close his file early. Once discharged, the bankrupt is released from his bankruptcy debts, and can begin to trade again or be a company director without the restrictions mentioned above. However, if the bankrupt's conduct has been irresponsible or culpable in some way he may have restrictions imposed on him for up to 15 years, notwithstanding his discharge.

After he has been discharged, the bankrupt does not have any right to take back from the trustee any property that was part of his estate in the bankruptcy. However, if there is a surplus after payment of all creditors in full plus interest, then this is returned to the bankrupt. In the meantime, the trustee will continue to hold these assets and apply them to the bankrupt's creditors.

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When does the trustee cease to act?

The trustee may continue to act after the bankrupt has been discharged if he needs to continue in office, for example if there are still assets to realise or creditors' claims to be agreed.

Also, the trustee may cease to act before the bankrupt has been discharged if he has completed his work by that time.

The trustee may continue to act after the bankrupt has been discharged if there are still assets to realise or creditors' claims to be agreed

What should I do if I am dissatisfied with the trustee's handling of the case?

You should first contact the trustee to try to resolve the problem. If you are still not satisfied, you may be able to make an application to court.

If you think that the trustee is guilty of professional misconduct, you should contact his regulatory body.

R3 is the UK's leading trade association for licensed insolvency practitioners and business recovery professionals. R3 does not license or discipline its members; this is the responsibility of the practitioner's regulatory body. The regulatory bodies are:

The Association of Chartered Certified Accountants

Tel: 020 7396 7000

www.accaglobal.com

The Institute of Chartered Accountants in England and Wales

Tel: 020 7920 8100

www.icaew.co.uk

The Institute of Chartered Accountants in Ireland

Tel: 00 353 1 637 7200

www.icaei.ie

The Institute of Chartered Accountants of Scotland

Tel: 0131 347 0100

www.icas.org.uk

The Insolvency Practitioners Association

Tel: 020 7623 5108

www.ipa.uk.com

The Law Society of England and Wales

Tel: 020 7242 1222

www.lawsoc.org.uk

The Law Society of Northern Ireland

Tel: 028 9023 1614

www.lawsoc-ni.org

The Law Society of Scotland

Tel: 0131 226 7411

www.lawscot.org.uk

The Insolvency Service

Tel: 020 7291 6895

www.insolvency.gov.uk

Further advice and information for creditors of failing businesses is contained in R3's *Ostrich's Guide to Business Survival*, which can be downloaded from the R3 website www.r3.org.uk free of charge.

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