Annulment of a Bankruptcy Order citing the Bankrupts lack of Mental Capacity

Whilst there is a presumption capacity in an individual, when petitioning for bankruptcy both the petitioning creditor and their solicitor should have the issue at the forefront of their mind.

Pursuant to Section 282(1) of the Insolvency Act 1986 ("the Act") the Court has the power to annul a bankruptcy order where it appears that either:
(a) that, on any grounds existing at the time the order was made, the order ought not to have been made, or;

(b) that, to the extent required by the rules, the bankruptcy debts and the expenses of the bankruptcy have all, since the making of the order, been either paid or secured for to the satisfaction of the court.

The decision of *Howorth v Cartmel [2011] EWHC 36 (Ch)* confirmed that a debtor's lack of mental capacity could be a reason to annul bankruptcy order pursuant to s.282(1)(a) of the Act.

The Court deemed that the petitioning creditor had been aware of capacity issues with the debtor and had not brought them to the Court's attention. The Court held, in principle, that the petitioning creditor should pay the costs of the bankruptcy, which were believed to be over £360,000.00!

Turning to the recent case of Barry James Fehily and Elvin Lydia Fehily v Paul Atkinson and Glynn Mummery [2016] EWHC 3069. In this matter a husband and wife had jointly entered into an IVA, which had defaulted and the IVA supervisor who subsequently petitioned for the couple's bankruptcy.

The husband and wife (the Applicants in this matter) applied for annulment on the grounds of section 282(1)(a) stating that the making of such an order had been unfair. After the applications had been issued the husband raised, for the first time, that his wife had lacked capacity at the time of entering into the IVA and contended the IVA could not be deemed valid as his wife would not have understood the IVA.

His wife had suffered a series of strokes and these were said to have had a serious impact on her cognitive capacity as she could not retain information or make decisions sufficiently. Letters from her GP were provided in support of the claim and these described the above but they made no mention that she lacked capacity. The husband and the wife's daughter also submitted witness statements stating their impressions of her medical condition. At the hearing, the District Judge relied on the test for capacity, stated in Chitty on Contracts that the party in question should have an understanding of the general nature of what he was doing. The District Judge held that there was insufficient medical evidence on which to conclude that the wife had lacked capacity to enter into the IVA. The District Judge therefore dismissed the applications.

The Applicants in this matter appealed this decision on two grounds:

(1) The District Judge had applied the wrong test for determining capacity;

(2) The District Judge failed to take proper account of the husband's further evidence

The Appeal was dismissed and the reasoning represents helpful commentary that we consider could be applied more widely.

(1) For the wife to understand the IVA, she would have needed to consider, understand and retain relevant information and to weigh that information as part of making any decision. The Judge stated the question was whether or not the person had the ability to understand the transaction, not whether they actually understood it, *Beaney (Deceased), Re [1978] 1 W.L.R. 770* applied. So, she merely needed to understand the key features of the IVA, she did not have to understand every detail. The Judge stated that the District Judge had applied the correct test and had been entitled to conclude that she had failed to prove her lack of capacity.

(2) There was no justification for admitting the witness statements of the husband and daughter about their impressions of her medical condition. The Judge stated that the District Judge had been right to reject their evidence, since evidence about capacity were to be made with the assistance of expert medical evidence and not family members who were unqualified.

The Judge did go onto state that should the wife have lacked capacity at the time of the signing of the IVA, the IVA would nevertheless have remained binding since a contract entered into for consideration by a person lacking capacity to understand the transaction was valid unless the other contracting party was aware of the incapacity, *Imperial Loan Co Ltd v Stone [1892] 1 Q.B. 599* followed.

The Restructuring and Insolvency Team at Blake Morgan LLP has extensive experience of dealing with recovery cases involving capacity concerns. If you'd like to discuss a specific issue or case please call 029 2068 6003 to speak to James Bowen or 029 2068 6181 to speak to Paul Caldicott.

James Bowen

Restructuring and Insolvency Executive
T: 029 2068 6003
E: james.bowen@blakemorgan.co.uk

Paul Caldicott

Partner
T: 029 2068 6181
E: paul.caldicott@blakemorgan.co.uk