

TEN TIPS FOR FINANCIAL PROVISION IN A RECESSION

So we have moved into recession. Values are no longer increasing. House prices have fallen. Businesses are doing badly. The banks are not lending. Sequestration looms. But couples are still falling out. We are now applying the Family Law (Scotland) Act 1985 in a different economic climate. Here are ten tips for representing clients in the lean years. Like all tips, they will require to be applied with a certain discrimination. Not all will apply in every case and in some cases something altogether different may be called for. They may serve to provide an interesting commentary on recent and potential developments in the law relating to and affecting financial provision. In common with many possible courses on the cutting edge of new situations they may be contentious. Time will tell whether they are all good tips, but they are offered for consideration.

1. DO seek diligence on the dependence – but watch the new BAD provisions

If a spouse or civil partner looks likely to become insolvent, or to dispose of assets, or burden or secrete them, then there may be a case for arrestment or inhibition. This will give the spouse or partner seeking provision security for his or her claim. Arrestment and inhibition can no longer be sought under the Family Law (Scotland) Act 1985. The general law found in the Debtors (Scotland) Act 1987, as amended by the Bankruptcy and Diligence (Scotland) Act 2007 (the “BAD Act”), now applies. Special consideration has been given to claims for aliment and financial provision. Section 15C expressly provides that warrant for diligence on the dependence may be granted for future and contingent debts. There is good news in that the sheriff now has jurisdiction to grant both arrestment and inhibition (section 15A). There is no need to come to the Court of Session to seek inhibition. Further, for arrestments executed on or after 22 April 2009, the creditor is under an obligation to disclose, within 3 weeks, the nature and value of the property or funds arrested (Debtors (Scotland) Act 2987 section 73G, see commencement order SSI 2009/67).

There are however some detailed statutory rules to observe. An extra form is required by the court rules (OCR 6.A2, Form G4A, RCS 14A.2, Form 14A.2). The court will not grant warrant for diligence on the dependence without notice to the other party unless:

- (a) there is a *prima facie* case on the merits;
- (b) there is a real and substantial risk that enforcement of decree would be defeated or prejudiced by reason of the debtor being insolvent or verging on insolvency, or the debtor removing, disposing of, burdening, concealing, or otherwise dealing with all or some of his or her assets, were warrant not granted without a hearing; and
- (c) it is reasonable in all the circumstances to grant the warrant (section 15E).

If warrant is granted the court must fix a date for a hearing, order the creditor to intimate the date, and the hearing is treated automatically as if there was a motion for recall or restriction of the diligence (section 15K). The court rules specify how diligence

is to be executed. If the summons is not served within 21 days of execution of the diligence, the diligence will cease to have effect, unless the court extends the period (section 15G). If a motion is made for extension, the court will need to be addressed on the efforts to serve the summons and any special circumstances preventing or obstructing service.

There is a useful case on arrestment on the dependence, dating from 1995. In *Matheson v Matheson* 1995 SLT 765 a wife raised divorce proceedings against her husband and, believing that he was seeking to dissipate his farming assets, she obtained interim interdict against such disposal and arrested sums due to him by an auction mart. The court recalled the arrestments on the basis that they unduly interfered with ordinary trading activities without legitimate advantage to the wife. This was however on the basis that the husband had made full disclosure of the transactions and the application of the proceeds. Arrestments carry the indirect benefit of encouraging full disclosure.

2. DO ask the court to set aside gifts – and to interdict the recipient meantime

Section 18 of the Family Law (Scotland) Act 1985 is titled “orders relating to avoidance transactions”. This section allows the court to set aside or vary any transfer of, or transaction involving, property effected by the other party if the court is satisfied that the transfer or transaction had the effect of, or is likely to have the effect of, defeating in whole or in part a claim for financial provision or aliment. The section is derived from similar provisions in the Succession (Scotland) Act 1964 section 27, re-enacted with some modifications in the Divorce (Scotland) Act 1976 section 6. There has not been a reported case of a single successful application for reduction or setting aside under any of these sections. It may be that with recession the time for section 18 has arrived.

There are difficulties. When the power to make “anti-avoidance” orders was retained in 1985 no thought appears to have been given to how such an order would interact with the principles in section 9 of the Act. ‘Matrimonial property’ is defined by reference to what belonged to the parties on the relevant date (1985 Act, section 10(4)). If a spouse has given away property in anticipation of separation, the court may set aside the gift. Prior to the order being made that property was not matrimonial property. Is the effect of the order setting aside the disposal to add the restored property to the pool of matrimonial property?

The Inner House has clarified that it is possible to interdict third parties holding transferred property from disposing of it pending determination of the claim. Despite the best efforts of trustees who had received over £3 million from a husband and would have preferred not to be holding the property when the court came to decide on whether this transfer should be set aside, interdict was confirmed to be competent (*M v M and Wards Estate Trustees* [2009] CSOH 65, 2009 SLT 608; [2009] CSIH 62, 2009 FamLR 119).

3. DO seek a transfer of property that has diminished in value

There is a silver lining to the cloud of recession for those who seek transfer of the family home. Applying *Wallis v Wallis* 1993 SC 49 to a downward trend in house prices would have resulted in transferees paying over the odds, but the Family Law (Scotland) Act 2006, section 16, amending section 10 of the 1985 Act, changed all that, so it is once more a transferee's market.

The effect of the 2006 Act is not yet clear. That is because there are three possible ways of interpreting how the new provisions are to be operated. The amendment to section 10 requires an "appropriate date" (usually current) value to be used for property transferred, but it is not clear whether the current value is to be applied at the relevant date as well as when calculating the credit given for any transfer, nor is it clear whether the same value has to be used for both parts of a joint interest.

In *Sutherland v Sutherland* 2008 FamLR 151 Sheriff Kinloch treated both parts of a joint interest as having their current value for the purposes of calculating a fair share of the net value of the matrimonial property and for the purposes of calculating the effect of a transfer of one party's interest to the other. His approach was rejected by Lady Smith in *Watt v Watt* 2009 FamLR 62. She held that "the (husband's) one half shares in the property in respect of which transfer orders are sought requires to be included at current value in any calculation of what he is due to pay the (wife), whilst the (wife's) retained shares requires to be included at separation date values." Taken at face value in a rising market this would have given the husband some, but not all, of the benefit of the increase in value of the house. However in implementing her decision Lady Smith calculated the sum to be paid on the basis of relevant date values, and gave credit for transfers at current values. The effect of her decision in practice would have been no different to *Sutherland* had she ordered equal sharing. For those who like to look at the figures, a worked example based on hypothetical figures and equal sharing is appended.

4. DO ask for security

Section 14(2)(f) of the Family Law (Scotland) Act 1985 allows the court to make an order that security be given for financial provision. An order for security, like an order for sale, is an order for financial provision in terms of section 8(1)(a). It requires to be justified by the principles in section 9 and reasonable having regard to the resources of the parties in terms of section 8(2). It cannot prejudice the rights of third parties (section 15(3)). According to *Macdonald v Macdonald* 1995 SLT 72 an order for security for payment of a capital sum can be granted even in the absence of a conclusion for security. In that case the defender was sinking into debt. The family home was to be sold and the wife was becoming alarmed that if his creditors seized the proceeds and her capital sum was not paid, she might not be able to purchase alternative accommodation. The husband resisted a security, arguing that if a security right was imposed on his share of the proceeds, his bank would be disturbed and might take immediate steps which would destabilise his financial position. Lord Caplan took

the view the pursuer's conclusion for a capital payment would cover incidental orders relating to it, including security. While this approach was helpful in the particular case, if there is no conclusion for security, then there is a clear risk that the court will find that there has not been fair notice of the point. It is safer to include a conclusion or crave for security, not least so that the rights of third parties can be considered.

In theory, if there is a problem over payment, it should be possible to seek security after decree has been pronounced. An incidental order for security may be granted "before, on or after" decree (section 14(1)). There have been difficulties in seeking incidental orders after decree in Glasgow Sheriff Court (*Amin v Amin* 2000 SLT (Sh Ct) 115) where the sheriff principal sustained the decision of a sheriff who refused an order for sale after decree, but that case proceeded under old sheriff court rules, and there does not appear to have been a full citation of authority. It may have assisted the sheriffs to consider Lord Macfadyen's approach in *Jackson v Jackson* (1999 FamLR 108) albeit *obiter* as he was not actually required to order sale. Again if there is an issue over ability or willingness to pay, then it is better to raise this at the time of divorce.

An order for security over heritable property is relatively straightforward. It can be helpful to lodge a draft, to make it completely clear what you have in mind. This will have the added benefit that there is a document to sign at court, in the event of settlement on the morning of the proof. Security need not be confined to heritable property. It is more tricky in the case of (say) shares, but not impossible. It is possible to take a pledge of shares, by asking for delivery of share certificates and a completed stock transfer form for the payee to register in the event of default. In the case of a pledge of shares the assistance of a colleague who practices in commercial law may be useful in drawing up conditions to protect a payee, such as limiting loans, dividends and emoluments to be paid by the company.

5. DO consider a pension-sharing order

If there are likely to be difficulties over payment, then a pension-sharing order becomes relatively more attractive. If the paying spouse or partner is liable to slip off overseas, then he or she is unlikely to be able to take the pension. It will represent one part of an award, and perhaps the only part, that can be enforced, because it falls to be enforced directly against third parties. In modern business conditions a pension fund may be part of the operation of a business. The fund may own the premises from which a spouse or partner trades. There should however be a professional trustee involved. The recipient spouse may find himself or herself in control of the business premises, along with a pension trustee. What happens as regards the future investment of the fund will be a matter for the persons responsible for the pension arrangement.

A pension-sharing order may be enforced even where the spouse or partner has been sequestrated. Caution is however required, as the trustee in the sequestration has the power to apply to the court for recovery of excessive pension contributions (Bankruptcy (Scotland))

Act 1985, ss 36A – 36F). This is a measure designed to prevent a person putting assets beyond the reach of creditors by stashing them in a pension fund. A pension-sharing order or agreement can be unpicked if:

- it can be shown to a court that the pension sharing order or agreement had the effect of defeating creditors (e.g. it was a gratuitous alienation or an unfair preference); and the pension rights transferred to the former spouse could not have been made without including the fruits of unfair contributions; and
- even when the unfair contributions are treated as being used in the first instance to produce the bankrupt's share of the pension, some of the former spouse's share of the pension is derived from the unfair contributions.

If the part of the bankrupt's pension not derived from unfair contributions was sufficient to fund the share that passed to the former spouse or partner, then the former partner or spouse may escape recovery of his or her share, but if any of that share could not have been made other than from the fruits of unfair contributions, that amount is recoverable by the bankrupt's permanent trustee. The legislation itself is impenetrable, but there is a helpful Explanatory Note appended to the Welfare Reform and Pensions Act 1999.

Care is required in relation to pensions that are underfunded, and many now are underfunded. The message from actuaries is to ask for a clear example of how pension credits/debits would be calculated. Asking for a percentage of an underfunded scheme may be more risky than seeking a particular pension credit. It is likely to be worth seeking advice on the effect of pension-sharing in any event as there have been recent changes in the prescribed methods for valuing occupational pension schemes. New valuation factors apply to separations after 1 October 2008. These tend to result in higher values for occupational pensions. It may be a disappointment to secure a pension credit of a particular value, and then find that this reflects a lesser pension than would have been secured by the same specified amount of credit based on a pre-1 October 2008 value.

6. DON'T discount a claim by reference to resources if the opponent is about to be sequestrated

Pitching a claim where there is a sequestration in the offing may be tricky. If resources are limited, then it might be thought that the claim should be restricted by reference to section 8(2)(b). If the payer is subsequently sequestrated then the trustee can seek to recall orders for payment of a capital sum, transfer of property, or pension-sharing on the ground that the payer was already insolvent or was rendered insolvent by the making of the order (Bankruptcy (Scotland) Act 1985 section 35). The problem may arise with particular force in the case of transfer of property. If there is a capital sum due and unpaid, then the payee will have to take his or her chance as a creditor, alongside other creditors, in the sequestration.

On the other hand when the potential payee is sequestrated while the claim for financial provision is pending it may be unwise to reduce the claim by reference to resources. That is because a claim for financial provision outstanding on the date of a debtor's sequestration

counts as a contingent debt and the spouse or partner claiming financial provision is entitled to rank as a creditor. This was recognised in *Crichton v Crichton's Trustee* 1999 SLT (Sh Ct) 113. While this is a sheriff court case (decided by Sheriff Principal Hay, affirming a decision of Sheriff Sir Stephen Young, as he then was), it was argued by two senior counsel (Peoples QC and Drummond Young QC). The context was that a husband had raised an action of divorce and sought financial provision. Four years later, while his action was still pending, the wife was sequestrated. The husband intimated his action to the trustee, pressed on and secured an order for payment of a capital sum. The trustee refused to allow the husband's claim to rank in the wife's sequestration, maintaining that the debt arose after the sequestration. The sheriff ordained the trustee to accept the claim and his decision was affirmed by the sheriff principal. Trustees are not always familiar with this decision, and may refuse to accept claims from spouses. These matters were explored in *Lessani v Lessani* 2007 FamLR 81. The point is that the larger the spouse's claim relative to other debts, the greater the share of the bankrupt's estate that will be paid to the spouse.

In terms of section 22(9) and schedule 1 paragraph 3 of the Bankruptcy (Scotland) Act 1985 a spouse or partner seeking financial provision may apply to the trustee in the sequestration, or to the sheriff, to put a value on the claim. In practice, if the court determines the extent of a capital sum due in course of divorce proceedings, the trustee is likely to regard the decision as determinative for the purposes of the sequestration. The financial provision claim should however be intimated to the trustee, as it is the trustee, rather than the spouse or partner, that has the principal interest in defending the case. It may be important that the claim is pursued in the sequestration, rather than dropped to wait for better days. A contingent debt that exists at the date of the sequestration will be discharged when the debtor is discharged (Bankruptcy (Scotland) Act 1985, section 55(1)). This is the 'down side' of *Crichton v Crichton's Trustee*. If a claim that exists at the date of sequestration is not made against the trustee, it could be lost. It may not be easy to decide when a claim for financial provision comes into existence for the purpose of making a claim. The sheriff principal discussed the possibility that such a claim dates from separation, but held that the debt was there, at the latest, by the date of institution of divorce proceedings.

Once the debtor is sequestrated his or her estate will vest in the trustee (Bankruptcy (Scotland) Act 1985, section 31). This does spell the end for any claim for a transfer of property order while the debtor is sequestrated, although it may be possible to seek a pension-sharing order.

7. DO consider re-characterising the claim as an alimentary payment

If the payer may have resources in the future, then it may be possible to frame a claim that will bite on those resources, notwithstanding any sequestration and discharge. Section 55(2)(d) of the Bankruptcy (Scotland) Act 1985 provides that a debtor is not discharged from "any obligation to pay aliment or any sum of an alimentary nature under any enactment or rule of law or any periodical allowance payable on divorce by virtue of a court order or under

an obligation...” and there then follows an exception for aliment that could have been included as a debt in the sequestration and child support outstanding at the date of the sequestration.

In *Lessani v Lessani* 2007 FamLR 81 the husband was sequestrated during the course of the divorce proceedings. The sheriff awarded a capital sum to the wife, partly under section 9(1)(a) of the Family Law (Scotland) Act 1985 and partly under section 9(1)(c) to share the burden of caring after divorce for the child of the family. The sheriff principal in Glasgow was prepared to accept that the award under section 9(1)(c) was alimentary in nature and could not have been claimed in the husband’s sequestration. The husband was not therefore discharged from the obligation to pay this part of the award. The practical point was that the trustee held sufficient to pay all the creditors in full and to return cash to the husband. The wife was able to claim the capital sum due in terms of section 9(1)(a) from the trustee and to appropriate a sum for the ‘alimentary’ award from any money the trustee would otherwise have returned to the husband.

If there is the possibility of enforcing a claim elsewhere in Europe, then it is again likely to be helpful to characterise as much as possible as an award as a payment of an alimentary nature. Council Regulation (EC) No 44/2001 (“Brussels I”) permits enforcement of maintenance in other member states of the EU. The Regulation does not permit enforcement of rights in property arising out of a matrimonial relationship. A capital sum may be “maintenance”, if it is designed to enable a spouse to provide for himself or herself or if the needs and resources of the spouses are taken into consideration in the determination of the amount. The court may make the position on these matters clear in its judgment (see *Van den Boogaard v Laumen*, [1977] ECR I-1147, 1997 QB 759; *AB v CD* 2007 FamLR 53).

8. DO remember interest – you can’t match the judicial rate

Where else in the present recession could a client receive interest at 8 per cent? The judicial rate of interest is now extremely attractive. In principle interest is due *ex lege* on unpaid awards of capital, aliment or periodical allowance and expenses (*Dalmahoy and Wood v Magistrates of Brechin* (1859) 21 D 210). Interest on an amount of financial provision may be awarded from a date prior to the date on which the principal sum falls due, pursuant to section 14(2)(j) of the Family Law (Scotland) Act 1985. *Geddes v Geddes* 1993 SLT 494 sets out Inner House guidance on when interest may be awarded. This is broadly as “consideration for the use and possession” of property a party has enjoyed between the relevant date and the date of decree. If a spouse or partner has had the enjoyment of property, but has paid aliment, then the argument for interest may be weak. If one party has been sitting on property, receiving the income from that property, and paying no aliment, then there will be a good argument for interest. Awards of interest are rarely sought. If there is an intention to seek interest then the principle of fair notice requires that the case for interest is outlined in averments (*Watt v Watt* 2009 FamLR 62).

Interest may not be awarded at the judicial rate. The court could take the view that having regard to all the circumstances a lesser rate was appropriate. This also applies to interest on instalments of capital (see *McHugh v McHugh* 2001 FamLR 30). The moral for the potential payer is that in cases where a question of interest may arise, consider the actual benefit from holding property and lead evidence on commercial lending and borrowing rates.

9. DO seek time to pay

If there is a difficulty in paying a capital sum, then the Inner House has given a clear signal that while the court may modify a claim to some extent, having regard to a party's resources, payment by instalments should be considered (*Sweeney v Sweeney No 2*, 2006 SC 82). The court adopted what it described as "a broad discretionary approach, having regard to the resources and to the form of the resources of both parties." They considered it reasonable that the husband should retain assets in readily realisable form to the value of about £100,000, to deal with business contingencies or other contingencies of life requiring ready funds. They recognised that he would have, some liability to capital gains tax and made a small allowance for that. The balance was to be paid in five instalments over a period of about three and a half years.

It is however necessary to set out the case for payment by instalments. The court may take the view that if a party had property on the relevant date, he or she will continue to have access to that property as a resource. If he or she does not have averments relating to resources, then no evidence can be led (*Fulton v Fulton* 1998 SLT 1262, 2000 FamLR 8). Potential payers must be realistic about the issue of resources. If a party declares to the court in evidence that he will "find the money somehow", he cannot complain if taken at his word, even if his brave assertion is at variance with other evidence about his resources (*Watt v Watt* 2009 FamLR 62). A recession is no time for heroics about resources.

If difficulties arise after an order is made, the court may vary the date or method of payment of a capital sum, or the date of transfer of property. The party seeking a variation must show a material change of circumstances (Family Law (Scotland) Act 1985, section 12(4)). There are no reported cases of variation – yet.

10. DON'T PANIC ...

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Worked example of effect of transfer of property orders

Rising market		<i>Wallis v Wallis</i>		Falling market		<i>Wallis v Wallis</i>	
<u>Wife</u>		<u>Husband</u>		<u>Wife</u>		<u>Husband</u>	
House	100,000	House	100,000	House	100,000	House	100,000
Bank	5,000	Shares	120,000	Bank	5,000	Shares	120,000
Policy	<u>15,000</u>	Pension	<u>250,000</u>	Policy	<u>15,000</u>	Pension	<u>250,000</u>
	120,000		470,000		120,000		470,000
Claim	175,000			Claim	175,000		
House	100,000			House	100,000		
Cash	75,000			Cash	75,000		
If house worth £300,000				If house worth £100,000			
Wife has paid £100,000 for £150,000 asset				wife has paid £100,000 for £50,000 asset			

2006 Act		<i>Sutherland v Sutherland</i>		2006 Act		<i>Sutherland v Sutherland</i>	
<u>Wife</u>		<u>Husband</u>		<u>Wife</u>		<u>Husband</u>	
House	150,000	House	150,000	House	50,000	House	50,000
Bank	5,000	Shares	120,000	Bank	5,000	Shares	120,000
Policy	<u>15,000</u>	Pension	<u>250,000</u>	Policy	<u>15,000</u>	Pension	<u>250,000</u>
	170,000		520,000		70,000		420,000
Claim	175,000			Claim	175,000		
House	150,000			House	50,000		
Cash	25,000			Cash	125,000		
Wife has paid £150,000 for £150,000 asset				Wife has paid £50,000 for £50,000 asset			

2006 Act		<i>Watt v Watt - as implemented</i>		2006 Act		<i>Watt v Watt - as implemented</i>	
<u>Wife</u>		<u>Husband</u>		<u>Wife</u>		<u>Husband</u>	
House	100,000	House	100,000	House	100,000	House	100,000
Bank	5,000	Shares	120,000	Bank	5,000	Shares	120,000
Policy	<u>15,000</u>	Pension	<u>250,000</u>	Policy	<u>15,000</u>	Pension	<u>250,000</u>
	120,000		470,000		120,000		470,000
Claim	175,000			Claim	175,000		
House	150,000			House	50,000		
Cash	25,000			Cash	125,000		
Wife has paid £150,000 for £150,000 asset				Wife has paid £50,000 for £50,000 asset			

2006 Act		<i>Watt v Watt - as stated?</i>		2006 Act		<i>Watt v Watt - as stated?</i>	
<u>Wife</u>		<u>Husband</u>		<u>Wife</u>		<u>Husband</u>	
House	100,000	House	150,000	House	100,000	House	50,000
Bank	5,000	Shares	120,000	Bank	5,000	Shares	120,000
Policy	<u>15,000</u>	Pension	<u>250,000</u>	Policy	<u>15,000</u>	Pension	<u>250,000</u>
	120,000		520,000		120,000		420,000
Claim	200,000			Claim	150,000		
House	150,000			House	50,000		
Cash	50,000			Cash	100,000		
Wife has £25,000 more				Wife has £25,000 less			