Bankruptcy and Family Law

Nabil Wahhab
York Family Law

TABLE OF CONTENTS

ABOUT THE AUTHOR

Nabil Wahhab is a Director at York Family Law, Sydney.

Nabil graduated from Macquarie University with an Honours degree in Law and Economics (majoring in Finance). He is an Accredited Specialist in Family Law and is a trained Mediator. His main area of interest lies in advising and representing clients on complex financial matters. He has an impressive track record of representing the interests of a wide range of high net worth individuals as well as third parties in complex property settlements.

Nabil acted for one of the parties in the first superannuation splitting case heard by the Family Court after the new amendments made to the *Family Law Act*, which enabled the court to split super between spouses.

He regularly publishes on financial family law issues in a variety of well respected legal and financial journals including LexisNexis Butterworths, CCH, Money Management, Lawyers Weekly, and others. He regularly presents on family law issues to lawyers, accountants, and financial advisers on family law.

Nabil previously worked at the Legal Aid of NSW where, amongst others, he represented children in family law matters. He remains on the Legal Aid Panel where he represents children in family law disputes. He has considerable experience of dealing with this particularly emotionally charged area.

Email: nwahhab@yorkfamlaw.com.au

Bankruptcy and Family Law*

Nabil Wahhab

1 Introduction

1.1 On 18 March 2005, the *Bankruptcy and Family Law Legislation Amendment Act* 2005 received Royal Assent ('BAF Act'). Schedule 1 commenced on 19 September 2005.[1] According to Mr Ruddock, the new amendments demonstrate "the Government's continuing commitment to reform family law and bankruptcy law ... There have been long standing concerns about the uncertainty facing both bankruptcy trustees and non-bankrupt spouses when these two areas of law operate concurrently."

1.2 The BAF Act implements recommendations from the Joint Task Force Report on the *Use of Bankruptcy and Family Law Schemes to Avoid Payment of Tax*. The BAF Act's genesis is founded in two court decisions, one involving a bankrupt barrister in the Federal Court and the other a non-bankrupt not-separated company director of the failed One.Tel company in the Family Court.

1.3 Over the years (ie, prior to commencement of the BAF Act) there have been a number of cases where parties litigating in the Family Court found themselves concurrently litigating in other courts in relation to bankruptcy. The cost for parties in those cases would have been very significant. There has always been a tension as to which court should determine the bankruptcy issues, the Family Court or other courts such as the Federal Court. The BAF Act

---

* This paper was last presented for The CLE Centre on 10 March 2006 (06/10.5) and has been updated for presentation on 9 March 2007 (07/10.4).

1 Schedule 2 came into effect on 18 March 2005. Schedule 2 amends the *Bankruptcy Act* and deals with income contributions. Schedules 3, 4, and 5 came into effect on 15 April 2005. Schedule 3 amends the definition of "maintenance agreement" under the *Bankruptcy Act* to exclude financial agreements from the definition. Schedule 4 deals with financial agreements entered into after 15 April 2005 by making certain transfers of property pursuant to a financial agreement to be treated as acts of bankruptcy. Schedule 5 deals with creditors and other interested parties to have standing in Family Court cases including standing in s106B applications and right to seek to set aside orders under s79A; a separation declaration must be signed by parties to a financial agreement prior to the agreement having effect.

gives the Family Court jurisdiction to deal with concurrent bankruptcy and family law proceedings. This is a welcome change for family lawyers and their clients. Bankruptcy trustees, however, may be disappointed with the change and may view the proposed amendments as a win for the family over creditors!

1.4 Bankruptcy trustees' apprehension about being drawn into the Family Court may be warranted. Most people try and avoid that Court! Bankruptcy trustees have been thrown in. Most of them have never been before a Family Court judge and would not be aware how Family Court Judges will balance the interests of the family versus the interests of the creditors. Most Family Court judges do not have the experience that judges in the Federal Court have in respect of bankruptcy law. It is unchartered territory for the majority of trustees, family lawyers, and Family Court judges.

1.5 So far, there has only been a handful of cases at first instance on the BAF Act.[2]

2 Overview of bankruptcy and family law clashes

Under the law as it stood prior to 19 September 2005, a party could not commence Family Court proceedings for property settlement or spouse maintenance if the other spouse was bankrupt. In cases where at the time of the parties' separation, one of the spouses was bankrupt, the non-bankrupt spouse had to fight for their rights to claim part of the property of the bankrupt spouse in another court.

3 Contributions: bankruptcy law v. family law

3.1 In the Federal Court, the non-bankrupt spouse generally outlined their financial contributions made to the acquisition, conservation, and improvement of the property in question, and their non-

---

2 *Trustee in Bankruptcy v. Watkins* (unreported, 6 October 2006, per Justice Stevenson); *Macks v. Edge* [2006] FCA 1077 (18 August 2006); *Official Trustee in Bankruptcy & B and G (deceased)* [2005] FamCA 1163 (1 December 2005). In *B and G*, the parties agreed that the old law should apply. The Honourable Justice Young said in obiter that the BAF Act is prospective in operation (see para 93). With respect to the Honourable Justice Young, the writer disagrees with his Honour's obiter comment on the operation of the new amendments.

financial and homemaking and parenting contributions in order to show that they gave valuable consideration for the transfer of property.

3.2 In a number of cases at first instance, judges found that such contributions were valuable consideration, especially if the non-bankrupt spouse had agreed not to make a claim for property settlement[3], or that the property is received pursuant to court orders.[4] However, the Full Court of the Federal Court in *Official Trustee in Bankruptcy v. Lopatinsky*[5] said that financial and non-financial contributions to the marriage of a type referred to in s79 of the *Family Law Act* 1975 did not constitute valuable consideration.

3.3 In other cases, both in the Family Court and the Federal Court, it was held at first instance that "forbearance to sue" is valuable consideration. For example, in *Lopatinsky*[6], Moore J found that the wife's promise not to sue her husband in the Family Court (ie not to make an application for property settlement) was valuable consideration. On appeal, however, the Full Court in *Official Trustee in Bankruptcy v. Lopatinsky*[7], found that such forbearance to sue was not established because Ms Lopatinsky could still bring an application for property settlement as no orders had been made.[8] In *Re Sabri; Ex parte Brien v. Australia & Zealand Banking Group Ltd*[9], Chisholm J held, amongst others, that orders of the Family Court finalising financial arrangements between spouses is consideration in the sense that such a compromise is akin to "forbearance to sue" and as such the chose in action which the wife gave up by entering into the orders has value.

3.4 Under the *Family Law Act*, the Court evaluates the respective financial and non-financial contributions of each of the parties to

---

3 *Lopatinsky v. Official Trustee in Bankruptcy* (2002) 29 Fam LR 274 (per Moore J).

4 *Mateo v. Official Trustee in Bankruptcy* (2002) 28 Fam LR 499 (per Tamberlin J).

5 (2003) 30 Fam LR 499.

6 Supra 3.

7 Supra 5.

8 See *In the Marriage of Woodcock* (1997) 21 Fam LR 393.

9 (1996) 21 Fam LR 213.

the acquisition, conservation, and improvements of the assets, as well as the homemaking and parenting contributions made by each of the parties. The Court also considers whether there should be any adjustments to the notional division of the pool of property by reason of s75(2) factors. The *Family Law Act* outlines the legal entitlements of spouses to the assets and superannuation accumulated available at the hearing.

3.5 The genesis of "contributions" under the *Family Law Act* and the *Bankruptcy Act* is different and this will be the area of greatest challenge for the Family Court, namely how to balance the interests of the family versus the interests of creditors.

4 The *Bankruptcy Act*

4.1 It is important to gain an understanding of how the relevant sections of the *Bankruptcy Act* work and consider their impact on the Family Court when that Court exercises its jurisdiction concurrently under the *Family Law Act* and the *Bankruptcy Act*. This is most important because the first step will be to determine the property that vests in the trustee in bankruptcy. This is where the provisions of the *Bankruptcy Act* and the equitable principles will come into play. Once the property that vests in the trustee is established (known as "vested property") then, as will be seen later, the *Family Law Act* principles will apply.

4.2 As family lawyers, we may be asked to advise a non-bankrupt spouse about whether it would be preferable for them to consider separation and therefore have a matter dealt with in the Family Court versus the spouses remain living together and dealing with the claim in the Federal Court.

4.3 A word of caution: Note that as lawyers we do not give clients advice about separation nor do we encourage them to separate. That is a matter for them. We present them with advice on the basis of different scenarios that they seek advice upon.

4.4 The relevant sections in the *Bankruptcy Act* to consider are sections 115, 116, 120, 121, and 123 as well as ss139ZQ and 139ZS.

4.5 An understanding is also required of the equitable principles of 'forbearance to sue', constructive trusts and resulting trusts, and equity of exoneration.

4.6 Pursuant to s139ZQ a notice will be issued by the trustee and served on a person in relation to property that the trustee is of the view forms part of the vested property. It is similar to a demand notice, albeit the notice has legal consequences. Once served, the person served with the notice has to comply with the notice or challenge it. The notice can be challenged on the statement of facts or circumstances set out in the notice.

4.7 A person who does not challenge the notice and does not comply with it is guilty of a criminal offence under s139ZT.

4.8 In *Official Trustee v. Lopatinsky*[10], Whittlam and Jacobson JJ said the following in relation to a notice that is based on a wholly erroneous statement of facts:

> If no challenge could be made, a notice based on a wholly erroneous statement of facts would nevertheless give rise to a criminal offence. This would be so even if the amount of the "debt" was overstated and the bankrupt failed to pay the overstated amount.

4.9 Section 139ZS gives the court the power to set aside a notice if the court finds that the facts stated in the notice are inaccurate. A notice that has been set aside is taken not to have been given.

5 *Bankruptcy Act* provisions

Relation back period and void transfers[11]

5.1 By section 115(1) of the *Bankruptcy Act*, the bankruptcy of a person:

> shall be deemed to have relation-back to, and to have commenced at the time of the commission of the earliest acts of bankruptcy committed by that person within the period of six months

10 (2003) 30 Fam LR 499 at 521.

11 The Bankruptcy Legislation Amendment (Anti-Avoidance) Bill 2005 was introduced into Parliament to strengthen the "claw back" provisions in the *Bankruptcy Act* 1966. There are six areas of reform proposed including increasing the claw back period from two to four years for transfers made to a related entity for less than the market value and allowing trustees to recover property disposed of prior to bankruptcy or owned by a third party from the bankrupt's resources.

> immediately preceding the date on which the creditors petition was presented ...

5.2 Section 120(1) of the *Bankruptcy Act* provides, subject to certain qualifications, that a transfer of property by a person who later becomes bankrupt to another person is void against the trustee in bankruptcy if:

- the transfer took place within 5 years of the commencement of the bankruptcy; and
- the transferee gave no consideration or gave consideration of less value than the market value of the property.

5.3 Section 120(3) of the *Bankruptcy Act* provides that a transfer in years 3-5 before bankruptcy can be protected if the transferee proves that the bankrupt was solvent at the time of the transfer.

5.4 Pursuant to s121 of the *Bankruptcy Act*, a transfer of property could be attacked notwithstanding that it is outside the 5 year period referred to in s120, if the trustee can show that the transferor's main purpose in making the transfer was:

- to prevent the transferred property from becoming divisible among the transferor's creditors; or
- to hinder or delay the process of making property available for division among the transferor's creditors.[12]

5.5 The transferor's main purpose in making the transfer can also be inferred from all of the circumstances if, at the time of the transfer, the transferor was, or was about to become, insolvent: s121(1)(b).

5.6 Sections 123 and 124 of the *Bankruptcy Act* "are designed to alleviate the position of persons dealing with the debtor, whose position is affected by the doctrine of relation back to the title of the trustee under s115".[13]

---

12 In *Prentice v. Cummins (No 5)* (2002) 124 FCR 67, Sackville J said that there is no requirement to establish an actual intent or sole or dominant intent. The applicant must establish that the debtor's "main purpose" was as described in s121.

13 McDonald, *Bankruptcy Law & Practice* at page 4682.

6 Equitable principles

"Forbearance to sue"

6.1 It has been held that forbearance to sue has always been regarded at law as good consideration.[14] Therefore, property settlement orders made by the Family Court have been held to be good consideration.[15] The effect of a Court order (unless the orders are challenged under s79A) is that a transfer of property pursuant to s79 is not "a transfer of property" under either ss120 or 121 of the *Bankruptcy Act.*

Resulting trust

6.2 A resulting trust is established if two or more persons contribute unequally to a property that is registered in their names as joint tenants; then there is an equitable presumption that they hold the title on a resulting trust for themselves as tenants in common in shares proportionate to their contributions: see *Calverley v. Green.*[16] The effect of a finding that a resulting trust exists, means that the non-bankrupt spouse is entitled to contribution in equity for that party's share of the payments and a charge to secure their equitable entitlement.[17]

6.3 How would one succeed in asserting a resulting trust in a family law context? The party asserting a resulting trust would need to show that they made financial contributions to the purchase of a property and/or further financial contributions such as meeting mortgage repayments, renovation costs, maintenance, and the like. The spouse would also need to show that the contributions to, say, the mortgage that they made were disproportionate and did not intend to benefit the other spouse!

---

14 See *Lopatinsky v. Official Trustee in Bankruptcy* supra 3 where Moore J quoted with approval Merkel J's dicta in *Victorian Producers' Co-Operative Co Ltd v. Kenneth* [1999] FCA 1488.

15 See *Mateo v. Official Trustee in Bankruptcy* supra 4. See also discussion of English cases on this issue in *Lopatinsky* supra 3 at 287-288.

16 (1984) Fam LR 950.

17 See *Official Trustee in Bankruptcy v. Lopatinsky* (2003) 30 Fam LR 499 at [116].

Constructive trust

6.4 Constructive trust is a remedial institution that is imposed by equity without regard to actual or presumed intentions of the parties. A constructive trust will be imposed where it would be unconscionable on the part of one of the parties to refuse to recognise the existence of an equitable interest in the other.[18]

Equity of exoneration

6.5 The principle of 'Equity of Exoneration' was discussed by Scott J in *Re Pittortou (a bankrupt): Ex parte Trustee of the Property of the Bankrupt* where His Honour said[19]:

> As a general proposition, if there is found to be a charge on property jointly owned to secure the debts of one only of the joint owners the other joint owner, being in the position of a surety, is entitled, as between the two joint owners, to have the security indebtedness discharged so far as possible out of the equitable interests of the debtor ...

6.6 In *Lin v. Official Trustee in Bankruptcy (No. 1)*[20], Raphael FM quoted the following passage by Dean J in *Farrugia v Official Receiver in Bankruptcy*[21]:

> Where the property of a married woman is mortgaged or charged in order to raise money for the benefit of her husband, it is presumed, in the absence of evidence showing an intention to the contrary, that, as between her husband and herself, she meant to charge the property merely as a surety. In such a case, she is, as between her husband and herself, in the position of surety and entitled both to be indemnified by the husband and to throw the debt primarily on his estate to the exoneration of her own. [Authorities cited].

6.7 Raphael FM also quoted the following passage from the Full Bench of the Federal Court in *Parsons and Parsons v McBain*[22] where in their joint judgment Black CJ, Kiefel and Finkelstein JJ at para 21 said:

> An equity of exoneration operates in the nature of "a charge upon the estate of the principal debtor by way of indemnity for the

18 See *Muschinski v. Dodds* (1985) 160CLR 583*; Baumgartner v. Baumgartner* (1987) 164 CLR 137.

19 [1985] 1WLR 58 at 61.

20 [2001] FMCA 106 (31 October 2001).

21 43 ALR 700 at 702.

22 [2001] FCA 376.

> purpose of enforcing against that estate the right which [the beneficiary] has, as between [the beneficiary] and the principal debtor, to have that estate resorted to first for the payment of the debt: Gee v Liddell [1913] 2 ChD 62 at 72".

Past consideration is no consideration

6.8 It is important to note that past consideration is no consideration. Once a marriage is over, contributions lie in the past. In *Official Trustee v. Mateo*, Wilcox J said the following[23]:

> Generally speaking, past consideration is no consideration: see The Law of Contract, Cheshire and Fifoot, 4th Australian edition, at para 211; The Law of Contract, Greig and Davis at 81-88. The only significant exception to that rule arises where there is an earlier promise to pay (express or implied). It is difficult to apply that exception to matrimonial contributions, unless, perhaps, there is a valid prenuptial agreement to that effect. There was no evidence of an earlier promise in the present case. It is no answer to these difficulties to argue, as do counsel for the respondents, that the consideration for Mr Mateo's consent to the Family Court orders was Mrs Mateo's consent. In terms of contract law, that may be true. But the issue under s121(4)(a) is not whether any consideration was given by the transferee for the transfer of property by the (now) bankrupt, but whether that consideration "was at least as valuable as the market value of the property". That brings the Court back to the problems I have mentioned.

7 Vested property

7.1 The assets that vest on bankruptcy come under the definition of "property" in s5(1) of the *Bankruptcy Act*:

> "**property**" means real or personal property of every description, whether situate in Australia or elsewhere, and includes any estate, interest or profit, whether present or future, vested or contingent, arising out of or incident to any such real or personal property.

7.2 In addition, "property of the bankrupt" in the same subsection, is also relevant:

> "**the property of the bankrupt**", in relation to a bankrupt, means:
>
> (a) except in subsections 58(3) and (4):
>
> (i) the property divisible among the bankrupt's creditors; and

23 (2003) 30 Fam LR at 140.

(ii) any rights and powers in relation to that property that would have been exercisable by the bankrupt if he or she had not become a bankrupt; and

(b) in subsections 58(3) and (4):

(i) the property, rights and powers referred to in paragraph (a) of this definition; and

(ii) any other property of the bankrupt.

7.3 In order to determine the "property divisible among the bankrupt's creditors", it is necessary to examine ss58 and 116(1) of the *Bankruptcy Act*.

7.4 Section 58 is in the following terms:

58 Vesting of property upon bankruptcy—general rule

(1) Subject to this Act, where a debtor becomes a bankrupt:

(a) the property of the bankrupt, not being after-acquired property, vests forthwith in the Official Trustee or, if, at the time when the debtor becomes a bankrupt, a registered trustee becomes the trustee of the estate of the bankrupt by virtue of section 156A, in that registered trustee; and

(b) after-acquired property of the bankrupt vests, as soon as it is acquired by, or devolves on, the bankrupt, in the Official Trustee or, if a registered trustee is the trustee of the estate of the bankrupt, in that registered trustee.

[Note 1: This subsection has a limited application if there are orders in force under the proceeds of crime law: see section 58A.]

…

(6) In this section, after-acquired property, in relation to a bankrupt, means property that is acquired by, or devolves on, the bankrupt on or after the date of the bankruptcy, being property that is divisible amongst the creditors of the bankrupt.

7.5 The property of the bankrupt that vests in the trustee on bankruptcy, is defined by looking at the definitions of 'property' and 'property of the bankrupt' set out in s5(1) (see above) and also by reference to the bankrupt's 'divisible property' in s116(1). This section is in the following terms:

116 Property divisible among creditors

(1) Subject to this Act:

(a) all property that belonged to, or was vested in, a bankrupt at the commencement of the bankruptcy, or has been acquired or is acquired by him or her, or

has devolved or devolves on him or her, after the commencement of the bankruptcy and before his or her discharge;

(b) the capacity to exercise, and to take proceedings for exercising all such powers in, over or in respect of property as might have been exercised by the bankrupt for his or her own benefit at the commencement of the bankruptcy or at any time after the commencement of the bankruptcy and before his or her discharge;

(c) property that is vested in the trustee of the bankrupt's estate by or under an order under section 139D; and

(d) money that is paid to the trustee of the bankrupt's estate under an order under section 139E;

is property divisible amongst the creditors of the bankrupt.

7.6 By tracking through the definitions in section 5(1), the 'divisible property' defined in section 116(1), and by considering the effect of section 58, it can be seen that immediately upon bankruptcy a pool of assets is established the legal ownership of which belongs to the trustee in bankruptcy for the benefit of creditors. This pool is then increased and decreased by operation of various other parts of the *Bankruptcy Act*. In general terms the pool will consist of items such as:

- interests in real estate (including as beneficiary of property in someone else's name);
- plant and equipment;
- cash;
- debtors;
- personal belongings (subject to certain minor exclusions – *see below*);
- shares;
- superannuation, life assurance or endowment assurance in respect of the life of the bankrupt *or the spouse of the bankrupt* and which together exceeds the pension RBL.

7.7 In itself, there is a considerable body of law as to the type of assets/property which forms part of this initial pool. This body of law is relevant in considering whether or not any particular asset under consideration will, in the event of bankruptcy, form part of the assets available for the benefit of creditors. A small selection of the types of assets found to be property vesting in a trustee in bankruptcy includes:

- interests in an undistributed deceased estate[24];
- choses in action which were available to a bankrupt to enforce equitable rights, even if the equitable rights arose after the sequestration order[25];
- rights to enforce judgments or orders, including in relation to costs.[26] In *Armour*, it was said (at [7]):

> When they became bankrupt after entry of the judgement on 28 February 2002, all of their property vested forthwith in their trustee in bankruptcy under s58 (1) of the *Bankruptcy Act* 1966 (Cth). Their property included the chose in action constituted by their right to enforce the orders made by Gzell J earlier in the day.
>
> It is beyond doubt that the word "property" in the definition of "property of the bankrupt" in s58 (1) extends to choses in action. There can be no suggestion that Gzell J's orders relate to some personal remedy of the bankrupts falling outside the concept of "property of the bankrupt" for the purposes of s 58 (1): cf *Lawindi v Elkateb* [2001] NSWSC 865 (Young J, 3 October 2001).

- rights of appeal in relation to property of the bankrupt.[27]

7.8 However the right to appeal against an order for compensation made **against** a bankrupt is not property of the bankrupt.[28]

8 What property does not vest in the trustee in bankruptcy?

8.1 Notwithstanding the definition of 'property' in s5 and the various other sections under the *Bankruptcy Act* referred to above, there

24 *Official Trustee v Jones* [2003] NSWSC 343.

25 *Pridmore v Magenta Nominees Pty Limited* (1999) 161 ALR 458; see also *Re Pevsner: ex parte Trustee in Bankrupt*cy (1983) 68 FLR 254.

26 *Armour v Mason* [2002] NSWSC 464.

27 *Bagshaw v Scott* [2002] FCAFC 362.

28 *Cummings v Claremont Petroleum NL* (1996) 185 CLR 124.

are significant other assets that do NOT vest in the trustee in bankruptcy but which the Family Court has jurisdiction over in altering property interests. These include:

- trusts where the bankrupt spouse is an appointor;
- property held by the bankrupt on trust for another person (including their spouse or former spouse);
- financial resources such as beneficiary under a trust;
- superannuation up to the RBL pension limit.

8.2 A new category of excluded property was also introduced by the BAF Act in the *Bankruptcy Act* (s116(9)) which excludes property the subject of a Family Court order made under the new legislation and which the trustee is required to transfer to the non-bankrupt spouse.

9 The BAF Act: will the merger be smooth?

Trustees' standing and rights in the Family Court

9.1 At the outset, it is important to note that the Family Court's jurisdiction following the enactment of the BAF Act is not exclusive. That is, the Federal Court still has jurisdiction under the *Bankruptcy Act*. This gives the option for litigants to invoke the new law, or rely on pre-existing rights under the *Bankruptcy Act* alone.

If an application is made for property settlement or maintenance, and one of the parties is bankrupt or subject to a personal insolvency agreement, then the trustee in bankruptcy has the right to apply to be joined as a party to the proceedings, and if this occurs, the court must join the trustee as a party.[29]

9.2 Once a trustee in bankruptcy is joined as a party to the proceedings, the bankrupt spouse is not entitled to make any submissions in connection with the property that has vested in an

29 See new s79(11) (as to property settlement) and s74(2) (as to spouse maintenance).

application for property settlement or spouse maintenance.[30] The court must not grant the leave except in certain circumstances.[31]

9.3 In relation to property that does not vest in the trustee (such as superannuation), it would be difficult to see the court not granting leave to the bankrupt spouse in respect of this part of the case.

9.4 Trustees are not able to commence proceedings under s79 of the *Family Law Act* 1975 ('FLA'). Trustees, however, have standing to bring proceedings under s79A FLA seeking to set aside orders that have already been made by the Court.

10 Property settlement – section 79, *Family Law Act*

10.1 The new s79(1) of the FLA reads as follows:

> In property settlement proceedings, the court may make such order as it considers appropriate:
>
> (a) in the case of proceedings with respect to the property of the parties to the marriage or either of them — altering the interests of the parties to the marriage in the property; or
>
> (b) in the case of proceedings with respect to the vested bankruptcy property in relation to a bankrupt party to the marriage — altering the interests of the bankruptcy trustee in the vested bankruptcy property;
>
> including:
>
> (c) an order for a settlement of property in substitution for any interest in the property; and
>
> (d) an order requiring
>
> i. either or both of the parties to the marriage; or
>
> ii the relevant bankruptcy trustee (if any);
>
> to make, for the benefit of either or both of the parties to the marriage or a child of the marriage, such settlement or transfer of property as the court determines.

10.2 For the first time, a non-bankrupt spouse will be able to make an application for property settlement under the FLA in the Family Court even though their former spouse is bankrupt or is a debtor subject to a personal insolvency agreement at the time the application is made. In the event that a spouse becomes bankrupt

30 See new s79(15); s74(6).

31 See new s79(16); s74(7).

during the proceedings, the law has changed in relation to vested property.

10.3 In those circumstances, the bankruptcy trustee will be joined as a party to the Family Court proceedings. This will by operation of a new s79(11) which provides as follows:

> If:
>
> (a) an application is made for an order under this section in proceedings between the parties to a marriage with respect to the property of the parties to the marriage or either of them; and
>
> (b) either of the following subparagraphs apply to a party to the marriage:
>
> i. when the application was made, the party was a bankrupt;
>
> ii after the application was made but before it is finally determined, the party became a bankrupt; and
>
> (c) the bankruptcy trustee applies to the court to be joined as a party to the proceedings; and
>
> (d) the court is satisfied that the interests of the bankrupt's creditors may be affected by the making of an order under this section in the proceedings;
>
> the court must join the bankruptcy trustee as a party to the proceedings.

11 Section 75(2)(ha) *Family Law Act*

11.1 A new s75(2)(ha) will be inserted into the FLA. The new sub-section provides for the Family Court, before making any orders in respect of vested property, to consider:

> (ha) the effect of any proposed order on the ability of a creditor of a party to recover the creditor's debt, so far as that effect is relevant …

11.2 The new sub-section is important because the new s79(1) does not provide that the Family Court must in altering the parties' interest, give all of the bankrupt's assets which have vested in the trustee to the trustee to distribute amongst the creditors. On the contrary, in relation to vested bankruptcy property, the court under s79(1)(b) has the discretion to alter the interests of the "bankruptcy trustee in the vested bankruptcy property". In doing so, no doubt the Court will be concerned with the non-bankrupt's contributions and the s75(2) factors, and it is when the court

examines s75(2)(ha) that the Court will look at the interests of creditors and balance them against the family. The sub-section does not give the trustee or the non-bankrupt spouse any priority. The playing field is level and in assessing the many s75(2) factors, one of the factors the court will look at will be s75(2)(ha).

12 The property pool in the Family Court

12.1 In family law proceedings involving bankruptcy, there will be three types of property that the Family Court will have jurisdiction over together with "another specie of assets"; namely:

Assets

- the non-bankrupt spouse's assets;
- the bankrupt's property vested in the trustee;
- the bankrupt's assets which do not vest in the trustee;

Another specie of assets

- the non-bankrupt superannuation; and
- the bankrupt's superannuation.

12.2 If proceedings are commenced by the non-bankrupt spouse after the spouse becomes bankrupt, the property of the bankrupt spouse would have vested in the trustee and therefore the non-bankrupt spouse will, in effect, apply for orders that he/she be entitled to part of the property vested in the bankruptcy trustee.

12.3 The steps the Family Court will adopt in cases involving bankruptcy issues will be as follows:

- **Determine the extent of vested property**: This is where the *Bankruptcy Act* provisions and the equitable principles apply to the property that initially vests in the trustee. For instance, a trustee may claim certain property as property that vests in the trustee. However, the non-bankrupt spouse may be able to establish a resulting or constructive trust in relation to part of the vested property. This will have the effect of shrinking the property that vests in the trustee. A non-bankrupt spouse may be able to show that a transfer of property from the

bankrupt to her which occurred within the five year period was done by him at a time when he was solvent and accordingly may be able to have the particular property excluded from vested property.

- **Apply ss79and 75(2) to vested property:** In this step, once the vested property pool has been identified the court will consider the contributions made by the non-bankrupt spouse to the vested property. The court under s79(1)(b) has the discretion to alter the interests of the "bankruptcy trustee in the vested bankruptcy property". What the court will look at in this step is the gross value of the vested property (not the net because the net will invariably always be nil or negative). In this step the court will be concerned with the non-bankrupt spouse's contributions to the vested property. In this way the court examines the non-bankrupt spouse's financial and non-financial, direct, and indirect contributions as well as their contributions as homemaker and parent.

- Once the court determines the notional division of the vested property between the non-bankrupt spouse and the trustee, the court examines s75(2) factors. There are now 17 factors that the court can take into account in s75(2). It is in s75(2)(ha) that the Court will look at the interests of creditors and balance them against the family. The sub-section does not give the trustee or the non-bankrupt spouse any priority. The playing field is level and in assessing the many s75(2) factors, one of the factors the court will look at will be s75(2)(ha).

- **Apply ss79 and 75(2) to other property and superannuation:** Again the Court will identify this asset pool and then assess the parties' contributions and s75(2) factors.

- **Bankruptcy Trustees' position:** It is likely that bankruptcy trustees will argue in doing justice and equity between all parties, the court should in its dealing with vested property consider whether the non-bankrupt

> spouse's entitlements could otherwise be met by a greater proportion of the property that does not vest in the trustee rather than impact on creditors by dividing the vested property between non-bankrupt spouse and creditors. It will be most interesting to see how the court meets that argument. It is respectfully submitted that given that the Court's business is not to engage in social engineering, it would be interested in engaging in financial engineering between creditors and non-bankrupt spouses. The business reality is such that creditors charge higher interest for unsecured debt because they recognise the risks of such lending.

13 Some examples of the interaction

In the case of *Macks v. Edge*, the Honourable Justice Besanko examined the application of the BAF Act. His Honour found as follows:

- The Federal Court still has jurisdiction and a trustee can (and, indeed, in cases where husband and wife have not separated, in particular), file in the Federal Court under the *Bankruptcy Act*. It will then be a matter of discretion as to whether the Federal Court transfers the proceedings to the Family Court;
- The first issue to be determined is whether a trustee's claim (to clawback property transferred to a non-bankrupt spouse) under the *Bankruptcy Act* ought to be upheld. It is at this point that the Court will look at matters in the *Bankruptcy Act*, namely ss120 and 121, as well as any defenses raised, being the equitable principles referred to above. His Honour said:

> > … the first issue in proceedings between the trustee and Mrs Edge is whether the trustee's claim under the provisions of the *Bankruptcy Act* ought to be upheld. If the trustee is successful then Mrs Edge may make an application against the trustee under s 79(1) of the *Family Law Act*, with respect to the freehold property, leasehold property and speedboat, seeking an order "altering the interests of the bankruptcy trustee in the vested bankruptcy property". It seems to me that that is the substance of any proceedings she may bring in the Family Court. Her claim is in a sense a contingent claim in that it only becomes relevant if the trustee's claim is successful. If the trustee is unsuccessful then Mrs Edge's claim falls away because there is no relevant vested bankruptcy property. Should the trustee be successful, the Family

> Court has the power to alter the interests of the trustee in the vested bankruptcy property.
>
> 42 In those circumstances, whether the order for transfer should be made comes down to whether it is appropriate in the exercise of the discretion to make the order for transfer. This Court can hear and determine the trustee's claim, but it cannot hear and determine Mrs Edge's claim should it become necessary to do so. If I make the order for transfer, the Family Court can hear and determine both claims. That is a powerful reason for making an order for transfer. On the other hand, the proceedings in this Court are nearly ready for hearing and, so far as I can see, involve some fairly concise issues. The hearing of the trustee's claim should not take very long. If the trustee's claim is unsuccessful, there will be no need for Mrs Edge to pursue the claim against the trustee in the Family Court. On balance, I am of the opinion that the proceedings should not be transferred to the Family Court.[32]

The *Bankruptcy Act* provisions and the equitable principles outlined above will play a significant part in either shrinking or increasing the asset pool of the non-bankrupt spouse (if they own property jointly with the bankrupt spouse), as well as determining the property that vests in the trustee. For instance:

13.1 if husband and wife have had consent orders made before bankruptcy or after bankruptcy and the trustee does not challenge them under s79A, then, ss120 and 121 of the *Bankruptcy Act* do not apply because a transfer pursuant to a s79 FLA has been held to be "not a transfer of property under either ss120 or 121.[33] However, note that if the bankruptcy commenced before the s79 order was made, the husband's interest in the property had already vested in the trustee and the husband had nothing to give.[34]

---

32 See 3 at para 41 and 42.

33 See *Official Trustee in Bankruptcy v. Mateo* supra 20; *Daniel v. Daniel & another* (2004) 32 Fam LR 160.

34 *Daniels* decision (supra 26) may not sit well with this statement. In D*aniels*, on 8 October 2003, a creditors petition was presented seeking a sequestration order in respect of the estate of the bankrupt husband. On 15 December 2003, the Family Court made orders following a contested hearing between the bankrupt and Mrs Daniels and ordered the husband to transfer by 1 February 2004 his interest in two properties. On 16 December 2003, the husband presented a debtors petition and the husband became bankrupt that day. On 27 January 2004, the trustee became registered with Mrs Daniels as proprietor of the properties. On 1 February 2004, the husband signed a transfer as per the court orders. Emmett J in the Federal Court followed the decision of Mateo and found that the trustee held his interest in trust for Mrs Daniels. Emmett J said that the trustee's remedy lies in bringing an action under s79A *FLA*.

13.2 if the parties enter into consent orders for maintenance, then *Mateo's* case may apply. Further, s123(6) of the *Bankruptcy Act* affords protection to maintenance orders. That sub-section reads as follows:

> Subject to section 121, nothing in this Act invalidates, in any case where a debtor becomes a bankrupt, a conveyance, transfer, charge, disposition, assignment, payment or obligation executed, made or incurred by the debtor, before the day on which the debtor became a bankrupt, under or in pursuance of a maintenance agreement or maintenance order.

Section 121 may be used to invalidate the maintenance order/agreement if one finds that the main purpose of the transfer was to "prevent the transferred property from becoming divisible among the transferor's creditors": s121(1)(b)(ii).

Section 118(1) of the *Bankruptcy Act* may also apply since it affords protection to a creditor (the non-bankrupt spouse) against property of a debtor in respect of a liability that arises under a maintenance order or agreement.

13.3 How will the equity of exoneration work in the Family Court? In identifying the assets of the parties (including that of the bankrupt property which has vested in the trustee), assume that the property in question is a family home owned jointly and there are two mortgages registered against the title. The first mortgage was obtained to assist in the purchase of the home but the second mortgage was obtained to assist the husband in running his company. According to the equity of exoneration, the non-bankrupt's net assets will be the value of the home less the first mortgage divided by 2. The second mortgage is not deducted from the value of the home as it is a debt used for another purpose. This has the effect of increasing the non-bankrupt spouse's assets. By doing so, the non-bankrupt spouse has effectively shifted a liability to the trustee in bankruptcy.

13.4 If the deposit on the home or renovations were made by the non-bankrupt spouse from, say, inheritance or a gift, then this creates a resulting trust in that the trustee holds part of the asset that belongs to the bankrupt in trust for the non-bankrupt spouse. So, for example, if the wife's parents gifted to her $200,000 which sum is used by the parties to buy the family home in joint names at a cost of, say, $600,000, the husband therefore has received a

benefit of 1/6 the value of the home. If the husband later becomes bankrupt, the trustee holds 1/6 of the bankrupt's interest in the home in trust for the wife.

14 Injunctions – section 114

A new subs(4) will be inserted in s114 as follows:

> If a party to a marriage is a bankrupt, a court may, on the application of the other party to the marriage, by interlocutory order, grant an injunction under subsection (3) restraining the bankruptcy trustee from declaring and distributing dividends amongst the bankrupt's creditors.

Note that you will have to satisfy the *Waugh* principles in relation to injunctions before the court will grant such an injunction.

15 Spouse maintenance

15.1 A new subsection (s72(2)) has been inserted in the FLA which provides:

> (2) The liability under subsection (1) of a bankrupt party to a marriage to maintain the other party may be satisfied, in whole or in part, by way of the transfer of vested bankruptcy property in relation to the bankrupt party if the court makes an order under this Part for the transfer.

15.2 That is, a non-bankrupt spouse may now make an application for spouse maintenance against a bankrupt spouse and the trustee notwithstanding that at the time the application is made the other spouse was bankrupt.

15.3 The court may in fact satisfy the spouse maintenance by making an order that such maintenance be paid to the non-bankrupt by a transfer of bankruptcy property.

15.4 Spouse maintenance could be applied for at any time during the course of the proceedings (interim spouse maintenance) or as a final order (final spouse maintenance order). There is a potential for the court to order interim spouse maintenance by making an order for the transfer of a property that has vested in the trustee. At the final hearing of the matter, the Court will still have to deal with the balance of the vested assets then remaining amongst the non-bankrupt spouse and the creditors. The Court could at this stage also order final spouse maintenance from the vested property. The effect of such orders for spouse maintenance is to

reduce the property pool available for distribution amongst the creditors.

15.5 A trustee in bankruptcy has the right to apply to vary or modify a spouse maintenance order under a new s83(1A). The trustee would need to show that material facts were withheld from the court or false material presented when the order for spouse maintenance was made. The trustee can also seek to set aside the order on the basis of an abuse of process, such as lack of full and frank disclosure. However, note should be made of s123(6) of the *Bankruptcy Act* in that such a transfer can only be invalidated under s121 of the *Bankruptcy Act*. Forbearance to sue may also play a role as to whether the orders would stand.

16 BFA: riches to rags?

16.1 On 15 April 2005, Schedule 3 of the BAF Act came into effect with the result that the Government closed the loophole of people using Binding Financial Agreements (BFAs) as a measure of "asset protection". On 27 December 2000, the FLA was amended to enable parties to enter into a BFA. BFAs can be entered into before the parties' marriage, during the parties' marriage, or after dissolution of the marriage. No one anticipated that the amendments made could create enough controversy to attract ASIC's interest in family law or for ASIC to bring an action in the Family Court seeking to set aside a BFA made between Jodie and Maxine Rich coincidentally on the eve of the collapse of One.Tel.

16.2 When the Government introduced the amendments in December 2000, it had in mind one thing, namely to ensure that parties in family law cases could oust the jurisdiction of the court and therefore provide parties with certainty as to their financial arrangements following their separation. The Government was interested in giving parties to a BFA certainty as to outcome. In this way, BFAs afford a good measure of asset protection, especially for parties who are about to be married and have significant wealth they do not want to share with their love ones if they separate down the track or for those parties who want to protect the family farm which has been in the family for

generations or for the purpose of excluding a business from a division of assets (particularly if there are other parties involved).

16.3 It was not envisaged when the new amendments came in on 27 December 2000 that parties could enter into BFAs which would have the effect of reducing one's assets and removing them from claims by third parties. The case of *ASIC v Rich & Rich* has brought this issue home. In that case, ASIC applied to set aside a BFA entered into on 31 May 2001 by Jodee and Maxine Rich. Jodee and Maxine were still married. Because of the way the *Family Law Act* was structured at that time, which has since been remedied following the decision, the Family Court did not have the jurisdiction to set aside the BFA. Third parties including government instrumentalities (like ASIC) and creditors can now apply to set aside BFAs entered into with a view to defeat or defraud creditors.

16.4 When BFAs became part of the FLA in 2000, an amendment was made to the definition of "maintenance agreements" in the *Bankruptcy Act*. Section 5 of the *Bankruptcy Act* defines "maintenance agreements" to include "a financial agreement within the meaning of the *Family Law Act* 1975".

16.5 On 15 April 2005, the definition of "maintenance agreements" in the *Bankruptcy Act* was amended to exclude BFAs. The effect of the amendment is that if parties had in the past or will in the future enter into a BFA where the effect of the BFA is to render a spouse bankrupt by reason of the assets that the bankrupt spouse provide for the other spouse, that BFA will be set aside. This has become law since 15 April 2005.

16.6 Further because BFAs will no longer form part of the definition of "maintenance agreements", a BFA will attract s120 of the *Bankruptcy Act* that provides that any transfer of property below market value is an undervalued transaction and therefore could be attacked and clawed back by the bankruptcy trustee. A transfer between spouses for no consideration is an undervalued transaction. A transfer for love and affection is also an undervalued transaction. The exclusion of BFAs from the definition of maintenance agreement will apply to all bankruptcies current on or after the commencement of the Bill.

16.7 It should be noted that the *Family Law Act* was amended effective 17 December 2003, whereby creditors, ASIC, and other government instrumentalities have had the right to apply to set aside a BFA that was entered into for the purpose of defeating or defrauding creditors.

16.8 What about the situation where parties have already entered into a BFA not for the purposes of defeating or defrauding creditors but for a genuine purpose of providing certainty in the event of their separation? What will happen if one of the spouses then becomes bankrupt, the parties separate, and the non-bankrupt spouse insists on their rights under the BFA? It is clear that the bankruptcy trustee would apply to set aside the BFA on one of two grounds, namely, that the BFA was entered into for the purposes of defeating or defrauding creditors or as an undervalued transaction under s120. How will the Family Court deal with that situation? Will the Family Court set aside the BFA as an undervalued transaction or will the Family Court uphold the BFA? What about the forbearance to sue argument that a non-bankrupt spouse advances about the effect of a BFA?

16.9 How can the Family Court conclude that a BFA which provides for a spouse to receive certain property on separation and in circumstances where the parties have conducted their married life on that basis be an undervalued transaction? How can the Family Court find that the homemaker and parenting role provided by the non-bankrupt spouse is an undervalued transaction? Certainly, if the BFA provides that the non-bankrupt spouse receive say 90% of the assets, then that may be viewed as an undervalued transaction or entered into with the main purpose of defeating creditors. But what if the BFA provides for the spouse to receive, say, 60% which on all accounts is within the range of orders the Court would otherwise have made?

17 Some ‘What ifs’

17.1 In altering the interests in property that has vested in the bankruptcy trustee, the Family Court will apply the same principles that it applies in all other family law cases and will examine the direct and indirect financial contributions of the non-

bankrupt spouse to the acquisition, conservation, and improvement of the property (which has now vested in the bankruptcy trustee); the direct and indirect non-financial contributions to the acquisition, conservation, and improvement of the vested property; and the homemaker and parenting role of the non-bankrupt spouse. Overall, the Court has to do justice and equity between the non-bankrupt spouses and the bankruptcy trustee.

17.2 One wonders how the Family Court will balance the interests of the creditors in respect of the vested property and the non-bankrupt spouse?

17.3 In family law proceedings where one of the spouses has been the financial activist during the course of the marriage and the other spouse was a homemaker and parent, in most cases, the Family Court assesses the contributions of each of the spouses at 50/50 (notional division) and then pursuant to s75(2) (the future needs factors) the Court adjusts the notional division by reason of a number of factors including health of the parties, income earning capacity of the parties, the care of children, payment of child support, and other factors (and the new s75(2)(ha) (referred to above)). The homemaker spouse generally receives an adjustment in their favour by reason of the s75(2) factors. How will the Family Court weigh all of the needs in s75(2) against the s75(2)(ha) factor? Who will be the winner?

17.4 There is a further layer of confusion in all of this, namely superannuation which does not form part of bankruptcy and therefore does not vest in the bankruptcy trustee but which, under the FLA, could be split between separating spouses. In the event that the Family Court orders, say, 50% of the bankrupt's assets in favour of the non-bankrupt spouse, will the Family Court make up the adjustments that it would otherwise make in favour of the non-bankrupt spouse by ordering a significantly higher percentage split of the superannuation entitlement of the bankrupt's spouse? Will the Family Court adjourn the proceedings until after the bankrupt spouse has been discharged from bankruptcy and then deal with the superannuation split?

18 Conclusion

18.1 The BAF Act will have far reaching implications on the way bankruptcy and family law will apply when they clash. Trustees may argue that the pendulum has swung in favour of the family and against trustees. By contrast, lawyers practising in family law may argue that for the first time the playing field is level.

* * * *