Don't go breaking my.... BFA

Some say Family Law is boring – but not when the likes of Jodee and Maxine Rich are involved. NABIL WAHHAB reports.

On December 27, 2000, the Family Law Act was amended to enable parties to enter into Binding Financial Agreements (BFA). When the Federal Government introduced the amendments, it had in mind one thing – to ensure that parties in family law cases could oust the jurisdiction of the Court and therefore provide them with certainty as to their financial arrangements in the event of separation.

In this way, BFAs afford a good measure of asset protection, especially for people who are about to marry and have significant wealth they want to protect, or for those who want to protect the family farm or exclude a business from the division of assets (particularly if there are other partners involved).

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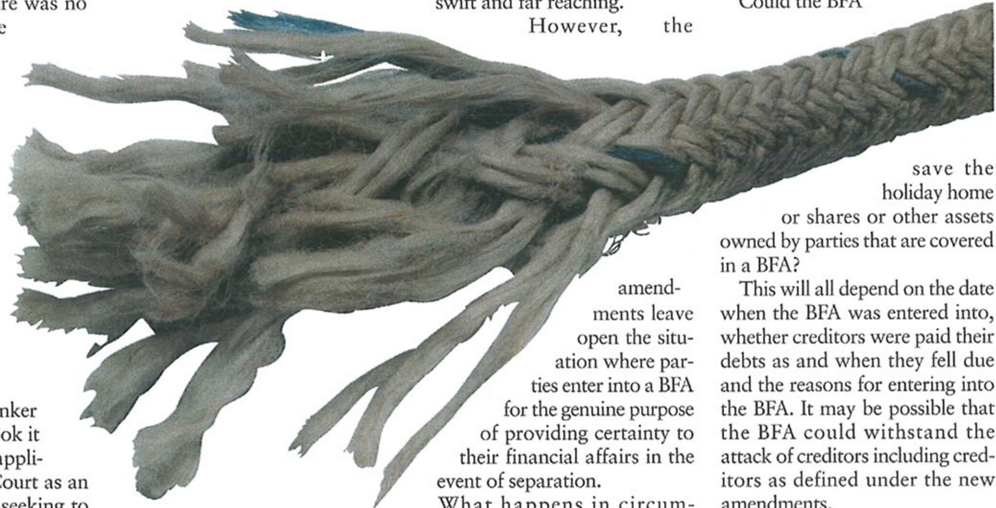

But that is exactly what Jodee Rich and his wife Maxine attempted to do. The attempt led to the Australian Securities and Investments Commission (ASIC) bringing an action in the Family Court seeking to set aside a BFA made between Rich and Rich – coincidentally on the eve of the collapse of One.Tel.

In the case of ASIC v Rich & Rich, ASIC applied to set aside a BFA entered into on May 31, 2001, by Rich and Rich. ASIC also sought consequential orders. Rich and Rich objected to the jurisdiction and sought dismissal of the application by ASIC. At the date of the hearing their marriage was (and remains) intact.

The matter was heard by Justice O'Ryan and a decision was handed down on October 15, 2003. Prior to the BFA, Mr Rich had net assets of approximately $9,455,000 and Mrs Rich had approximately $13,000,000.

The effect of the BFA was to increase Mrs Rich's total assets from approximately $13 million to approximately $16.5 million and to decrease Mr Rich's total net assets from approximately $9.455 million to approximately $3.9 million or 17.3 per cent of the total net assets.

On this redistribution of assets, the judge said "prior to the agreement the wife had assets of a value greater than the husband's assets and it is for this, and other reasons, that I find the legal advice recited in the agreement incredulous".

One of the salient features of the case before Justice O'Ryan was that the Rich marriage had not broken down and there was no application before the Court by either of them to set aside or tinker with the BFA. ASIC took it upon itself to file an application in the Family Court as an interested third party seeking to set aside the BFA.

After reviewing the case law in relation to third-party interests in family law cases, the Family Law Act together with the Bankruptcy Act, Justice O'Ryan came to the view that no part of the definition of "matrimonial cause" in the Family Law Act authorises the institution of proceedings by ASIC pursuant to section 90K (setting aside of BFA section). Justice O'Ryan therefore did not find jurisdiction and said: "If there is a right at law to prosecute against the Respondents in relation to the agreement it is in another court and without recourse to any power afforded by the Family Law Act."

Justice O'Ryan was alarmed at spouses generally using BFAs to protect their assets from third party creditors or where there is a prospect of bankruptcy.

"What is also of concern is that various commentators have stated that if there are third-party creditors or a business in serious trouble or there is the prospect of bankruptcy then the parties should settle by a financial agreement. This appears to be the advice that is being given to legal practitioners, and no doubt to their clients, and in my view, in certain circumstances, it may raise ethical issues," he said.

It was indicated before the Family Court that if ASIC fails in its application in the Family Court, it would proceed with an application under section 37A of the Conveyancing Act in the Supreme Court where that section provides that "every alienation of property made with intent to defraud creditors shall be voidable at the instance of any person thereby prejudiced".

Following the decision, as the writer understands it, ASIC sought to bring an action in the Supreme Court under section 37A of the Conveyancing Act. Shortly thereafter, in or about mid November 2003, a media release went out indicating that the Rich couple had terminated the BFA. Therefore, the BFA has, in effect, been set aside by the parties themselves by consent.

Federal Government reaction to ASIC vs Rich & Rich

On December 5, 2003, the Federal Government amended the Family Law Act to allow "third party proceedings" to apply to set aside BFAs. The Federal Government has been concerned that the Family Law Act could be used to defeat or defraud creditors.

"Third party proceedings" is defined to mean proceedings between: either or both of the parties to a financial agreement; a creditor or a Government body acting in the interest of a creditor; being proceedings for the setting aside of the financial agreement on the grounds specified in paragraph 90K(1)(AA).

Section 90K(1)(AA) provides that a BFA could be set aside by a court "if the agreement was entered for the purpose or purposes that included the purpose of defrauding or defeating a creditor or creditors of the party or with reckless disregard of the interests of a creditor or creditors of the party".

A creditor in relation to a party to a BFA includes a person who could reasonably have been foreseen by the party as being reasonably likely to become a creditor of the party.

The amendments to the Act are retrospective, that is, they catch all BFAs whether or not they were entered into before or after December 5, 2003.

The Federal Government's reaction to the use of BFAs has been swift and far reaching.

However, the amendments leave open the situation where parties enter into a BFA for the genuine purpose of providing certainty to their financial affairs in the event of separation.

What happens in circumstances where the parties may not have had any creditor at the time the BFA was entered into or if either of them had any creditors, they always paid their debts on time?

Let's consider the situation where a BFA provides that on separation one of the spouses would receive certain property (say the family home) and the parties set their lifestyle in accordance with the terms of the BFA so that the wife stays at home and looks after the children and the husband remains the financial activist.

If the parties separate some years down the track at a time when the husband has run into financial trouble, would a creditor succeed in setting aside the BFA and claim the family home as part of the bankrupt spouse's estate?

In my opinion, the BFA would not be set aside. By entering into the BFA, the wife in this example has given up a significant right (namely the right to bring a claim for property settlement under the Act) and, more importantly, the parties have arranged their affairs in a way where the wife's circumstances have been prejudiced (she may have given up her career for the benefit of the family and raising the children). She relied on the BFA to her detriment.

In such circumstances, the court would not set aside the BFA, notwithstanding there may not be sufficient assets of the husband to pay all of his creditors.

What about assets other than the family home?

Could the BFA save the holiday home or shares or other assets owned by parties that are covered in a BFA?

This will all depend on the date when the BFA was entered into, whether creditors were paid their debts as and when they fell due and the reasons for entering into the BFA. It may be possible that the BFA could withstand the attack of creditors including creditors as defined under the new amendments.

One of the lessons the ASIC v Rich and Rich case provides is that the earlier a BFA is prepared and the reasons for its preparation are certainty of outcome, estate planning and asset protection (but not from your creditors), the more likely the BFA will withstand challenge from creditors or potential creditors.

The case is a wake-up call to all financial planners to ensure their clients' financial planning is carried out as early as possible so that there is no need to recite what ultimately appeared in the Rich's BFA which read, in part: "Jodee's financial affairs have taken a significant turn for the worse and his financial future is under a cloud. Maxine is concerned that her professional career, as a lawyer and public company director, may be significantly compromised as a result of the adverse change in Jodee's circumstances."

One expects to read this type of statement in a bankruptcy judgment, not in a BFA.

Nabil Wahhab