



Who will win in bankruptcy, family law merger?

Legislation that will allow the Family Court to hear cases that involve bankrupts was re-introduced last month in an effort to simplify proceedings. However, writes **Nabil Wahhab**, the amendments could end up creating more confusion

The bankruptcy and family law roads are about to merge into one superhighway when the Bankruptcy and Family Law Legislation Amendment Bill 2004 (the Bill) becomes law. There have been many collisions between family and bankruptcy law in the past, so will this merger be smooth?

The Bill's genesis is founded on two recent decisions, one involving a bankrupt barrister in the Federal Court and the other a non-bankrupt, unseparated company director of the failed One.Tel company in the Family Court. Is the Bill an overreaction by the Government or a measured response to the clash between bankruptcy and family law?

There are four major amendments proposed in the Bill. Firstly, the Family Court gets exclusive jurisdiction to deal with concurrent bankruptcy and family law issues. This will avoid parties litigating in the Family Court and the Supreme Court at the same time about the same property but different laws being applied. This eliminates the question of which court should deal with the assets first.

Family lawyers and their clients welcome the change whereas bankruptcy trustees will be disappointed as they view the proposed amendments as a win for the family over creditors.

Bankruptcy trustees' apprehension about being drawn into the Family Court may be warranted. Most Family Court judges do not have the experience that judges in the Supreme Court have in bankruptcy matters, so it is uncharted territory for the majority of trustees and Family Court judges.

Currently, Family Court proceedings cannot be commenced if one of the spouses is bankrupt. In those cases, the non-bankrupt spouse has to apply to the Supreme Court to claim part of the property of the

bankrupt spouse. The non-bankrupt spouse must show that she/he made financial contributions to the acquisition of the property to get the property, otherwise the claim is dismissed.

The second amendment will allow non-bankrupt spouses to apply for property settlement in the Family Court even though their spouse was bankrupt at the time the application was made. The bankruptcy trustee will be joined as a party to the family law proceedings where the Court will put on two hats – its hat in applying the *Family Law Act* 1975 and its hat in applying the *Bankruptcy Act* 1966. Which hat will stay on the most may ultimately determine the outcome.

In altering the interests in property that has been vested in the bankruptcy trustee, the Family Court will apply the same principles that it applies in other family law cases and examine the financial contributions and family contributions made by the spouses. The Court must make orders that are just and equitable between the non-bankrupt spouse and the trustee.

That's not how the Supreme Court deals with these matters now. The Supreme Court does not put any value on family contributions. The Family Court, however, has said that such contributions are not inferior to financial contributions. The Family Court will likely give the same weight to the family contributions as the Supreme Court gives to financial contributions. That way, the non-bankrupt spouse may receive up to 50 per cent of the property. But what is the "property"?

Is it the pool of assets less all the liabilities? If so, there may be nothing to fight over because the value may be negative. Is the pool the assets less some of the liabilities? Now there is something to fight about. But what about the creditors whose liabilities have just been put aside? What will happen to those?

It sounds like it is all over for those creditors before the hearing even started.

It appears that the Family Court will assess contributions in the usual way so a spouse may end up with 50 per cent or more of the "assets". The Court may have to ignore some liabilities in order to give effect to the hard work put in by the "innocent spouse". That way, the wealthy creditor will miss out on recovering some of its liability. The innocent spouse will get something with which to move on in life and provide for the children. That way, everyone walks away unhappy. Sorry ... meant to say a balance has been achieved.

There is a further layer of confusion in all of this. Namely superannuation, which does not form part of bankruptcy and does not vest in the bankruptcy trustee and yet under the *Family Law Act* could be split. The Family Court may make a significantly higher percentage split of the superannuation entitlement of the bankrupt's spouse in favour of the non-bankrupt spouse because the Court cannot make up the balance of the non bankrupt's entitlement in any other way. Remember the creditors cannot touch super so the balance is left with the bankrupt for their retirement.

Spouse maintenance could also prove a nightmare for bankruptcy trustees and creditors. The Bill provides that a non-bankrupt spouse may make an application for spouse maintenance notwithstanding that at the time the application is made the other party was bankrupt. But who will pay the spouse maintenance? Yes, it may be the creditor (indirectly, of course).

The current law is that married people must, if they can afford to, support each other after separation. The Family Court examines two matters in spouse maintenance – whether a party has a need and if so, whether the other party has the capacity to pay spouse maintenance.

The Bill provides that the Family Court has the power to order property of a bankrupt, which has been vested in the bankruptcy trustee, be transferred to provide spouse maintenance for the non-bankrupt spouse. The effect of a spouse maintenance order will be to reduce the property pool available for distribution amongst the creditors.

The fourth significant change proposed is to close the gap on people using Binding Financial Agreements (BFA) as a measure of "asset protection". On 27 December 2000, the *Family Law Act* was amended to enable parties to enter into BFA. BFA's can be entered into before the parties' marriage, during the parties' marriage or after dissolution of the marriage.

When BFA amendments were made, the definition of "maintenance agreements" in the *Bankruptcy Act* was also amended to include "a financial agreement within the meaning of the *Family Law Act*". This was an oversight. Under

the current law, a BFA is afforded protection under bankruptcy. It should be noted, however, that if a party enters into a BFA for the purpose of defeating or defrauding creditors, then the creditors or ASIC or any other government instrumentality can apply to set aside the BFA.

BFA will be excluded from the definition of "maintenance agreements". So, if husband and wife enter into a BFA, the effect of which is to make one of them bankrupt, that BFA will be set aside.

As BFA will no longer form part of the definition of "maintenance agreements", BFA will attract s120 of the *Bankruptcy Act* which provides that any transfer of property below market value is an undervalued transaction and therefore could be attacked by the bankruptcy trustee. A transfer between spouses is potentially an undervalued transaction.

If parties enter into a BFA and then one of them becomes bankrupt, the trustee may attack the BFA as an undervalued transaction or argue that it was entered to defeat or defraud creditors.

Will the Family Court set aside the BFA? 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 family contributions provided by the non-bankrupt spouse over the years as an undervalued transaction?

The clash between bankruptcy and family law will be of titanic proportions because, on the one hand, the Court has to do justice between husband and wife and assess their respective contributions. At the same time the Court will be entrusted with looking after the interests of creditors and therefore apply the *Bankruptcy Act*.

The clash will be an unequal one as bankruptcy trustees will want to ensure the Family Court will uphold s120 of the *Bankruptcy Act* and the interests of creditors and will bring in the best silks to argue the case whereas non-bankrupt spouses, with perhaps limited funds, will argue that the Family Court should uphold a BFA or the family contributions made. It would be in the interest of justice, for all parties concerned in those early cases, for the Federal Government to provide funding to non-bankrupt spouses with limited funds.

The Bill will have far reaching implications for the way bankruptcy and family law will apply when they clash or merge. Trustees may argue that the pendulum will swing in favour of the family and against trustees. Family law lawyers will argue that the pendulum will swing in favour of trustees and against the family, especially in the area of BFAs.

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Circulations Audit Board: 14,280
(As at 31 March 2004)

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