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Editor's corner: special issue on family law and insolvency

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It is my pleasure to introduce Vol 18 issue 9 of the *Insolvency Law Bulletin*, which is a special issue on the theme of family law and insolvency.

At the time of writing this editorial, the Treasury Laws Amendment (2017 Enterprise Incentives No 2) Bill 2017 (Cth) had passed through both houses of parliament, but not before the government and opposition moving amendments through the Senate to further clarify the operation of ipso facto protections to self-executing clauses in contracts and to provide for a mandatory 2-year review of the new safe harbour protection for directors. The safe harbour commenced on 19 September 2017 (the day after Royal Assent), with the ipso facto protections to commence by proclamation or by 1 July 2018 at the latest. These reforms have been a long time coming and I'm sure insolvency practitioners and their advisors will welcome their introduction. No doubt there will be some period of adjustment, and the scope of both new sets of provisions will be tested in the near future.

The federal government has also announced consultation on a range of measures to address illegal phoenix activity, including a director identification number (DIN), increasing penalties, extending penalties to advisors and limiting particular director conduct such as resigning from a company to avoid personal liability. The matters for consultation were released on 12 September 2017 by Minister O'Dwyer. No doubt there will be considerable debate on these issues in the near future.

This is the fourth special thematic issue of the Bulletin in the past 18 months, with the prior issues covering:

- insolvency and trusts (Vol 17 issue 6);
- law reform (Vol 18 issue 3&4)); and
- insolvency and technology (Vol 18 issue 7).

We've received lots of positive feedback from readers and we look forward to continuing to offer detailed analysis on particular topics that are relevant to insolvency practitioners and their advisors in the future.

In this issue, we have a range of articles from legal and accounting practitioners and academics looking at the effect of family law on both personal and corporate insolvency. First, we have an article by insolvency practitioner Suelen McCallum from deVries Tayeh and family lawyer Karina Ralston from Coleman Greig Lawyers, which covers a broad range of practical and legal issues for bankruptcy trustees when family law matters arise in a bankruptcy administration. In particular, they critically assess the effectiveness of the 2005 amendments to the Family Law Act 1975 (Cth) and the Bankruptcy Act 1966 (Cth), which were designed to bring greater harmony to the interaction between both legal systems. As you will see, that harmonisation project has not been entirely successful.

Our second article is by Grant Malfitano from family law specialists Watts McCray Lawyers, who also reflects on the 2005 amendments as well as provides practical tips for bankrupts involved in family law proceedings. Our third article is by editorial board member Stephen Mullette and Renee Smith (both from Matthews Folbigg), who discuss the issue of the division of the family home in bankruptcy with reference to the recent decision in *Weston v McAuley*.[1] Our fourth article is by Jackie Jones, a collaborative family law specialist and clinical practitioner at the University of Technology Sydney, who considers the position of a bankruptcy trustee in alternative dispute resolution processes in family law matters. Our fifth article is by editorial board member Peter Leech from Cowell Clarke who examines binding financial agreements and their effectiveness against unreasonable director-related transactions under s 588FDA of the Corporations Act 2001 (Cth). Our sixth article is by co-editor Associate Professor David Brown who considers consent orders in the Family Court and s 588FDA. The issue concludes with a short reading list of recent articles on family law and insolvency.

Lastly, this is my final issue as co-editor of the *Insolvency Law Bulletin*. After 2 years of serving as General Editor (in 2016) and co-editor (in 2017) I'm cutting back on my external commitments to focus on finishing my PhD work on voluntary administration and corporate rescue. I've enjoyed working for the Bulletin,

particularly working with a wonderful editorial board and production team at LexisNexis and with my co-editor Associate Professor David Brown and all of the brilliant authors who contribute their work each month. I'll be moving to the editorial board from the end of this year and look forward to continuing to contribute to the Bulletin in that capacity.

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Footnotes

1. *Weston v McAuley* [2017] FCCA 1; BC201700940.

Bankruptcy and family law: oil and water still do not mix

Suelen McCallum *DEVRIES TAYEH and* ***Karina Ralston*** *COLEMAN GREIG*

Introduction

Way back in 1996, the Australian Financial Security Authority (AFSA or rather Insolvency and Trustee Service Australia (ITSA) as it was then known) held its first Bankruptcy Congress and one of the standout speakers was Stephen O'Ryan J of the Family Court who spoke on the interaction between the Bankruptcy Act 1966 (Cth) and the Family Law Act 1975 (Cth), which he described as being like the interaction between oil and water, in that they do not mix.

He also made the passing comment that the Bankruptcy Act and the Family Law Act "make strange bedfellows".

Sadly, here we are 20 years later and the two Acts still do not mix all that well. That is not surprising, since the two Acts come from different perspectives, and while the basic tenets of the Bankruptcy Act are based on equitable principles, under the Family Law Act equitable principles are merely a starting point before a number of other principles come into play which are solely applicable in family law matters. The major principles are the financial value placed on the "non-cash contributions" by the spouses, plus the "future needs of the spouses and the children of the marriage". While placing a monetary value on a spouse's decision to stop working to run the matrimonial home and raise the children is reasonably straightforward, it becomes more difficult to determine the monetary value where the spouse was previously not working or had only worked part-time.

It is common for someone in a relationship breakdown to be or become insolvent and it is often unclear whether the relationship breakdown led to the bankruptcy of one of the parties or whether the bankruptcy of one of the parties led to the relationship breakdown.

Prior to 2005, when significant changes were made to both the two Acts, it was basically a race between the solvent spouse and the creditors of that insolvent spouse to see who could obtain their order first. That was indeed a common scenario where the husband was operating a business which was going bust and his creditors were chasing him through the courts with the intent of making him bankrupt. In the meantime, the wife was instructing her lawyers to obtain property settlement orders in the Family Court whereby she would get the family home plus most of the other matrimonial property and a maintenance order thrown in for her and the kids.

If the husband's creditors obtained a sequestration order against him before the wife's lawyers could obtain the family law property settlement, then all the husband's divisible property and, in particular, his half interest in the matrimonial home, would vest in the trustee of his bankrupt estate and become available for the benefit of his proven unsecured creditors.

Consequently, the Family Court could not make orders in respect of the husband's half of the matrimonial home because it was no longer the property of a party to the marriage. Conversely, if the wife obtained her family law property settlement before the Federal Court made the sequestration order against the husband, the creditors missed out.

After amendments have been made to both the Bankruptcy Act and the Family Law Act in 2005,[1] a non-bankrupt spouse can now continue or commence an application under the Family Law Act for a property settlement and/or an order for maintenance against their bankrupt spouse. That spouse can now also seek an order from the Family Court or Federal Circuit Court that the trustee of the bankrupt spouse's estate transfer "vested property" (property of the bankrupt spouse that has vested in the trustee) to the non-bankrupt spouse in accordance with the terms of the property settlement and/or to satisfy the bankrupt spouse's liability for maintenance.

In making such an order, the court is required to consider the interests of all the parties including the effect of the proposed order on the creditors of the bankrupt spouse. Furthermore, the courts have held that the rights of the creditors have no priority and alternatively the children have no priority over the creditors.

Any notable difference?

One of the first orders made after the amendments came in seems to indicate that the Family Court has continued to rank the needs of the non-bankrupt wife (and particularly the children) over the creditors of the bankrupt spouse.

In the case of *West v West*,[2] the trustees of the bankrupt husband unsuccessfully endeavoured to resist the non-bankrupt wife's application under the Family Law Act that she be awarded the sole ownership of their jointly owned home. In addition to the court ordering the trustees to transfer the bankrupt husband's half interest in the home to his wife, the court ordered that the wife be paid 95% of the bankrupt's superannuation fund (which currently had an accumulated balance of $50,000) when it matured. The wife was entitled to retain her superannuation fund which had an accumulated balance of $9000.

In making the orders the court took into consideration a number of factors which made this case somewhat other than ordinary, including the following:

- Mrs West was the primary caregiver to their seven children;
- Mrs West had the ongoing care of the three children still at home;
- Mrs West was the homemaker and she had the primary responsibility for the children's physical, mental, emotional and intellectual needs;
- Mr West has had very little to do with the children during the marriage and since leaving;
- Mrs West raised seven children while working on and off throughout the duration of the marriage collecting shopping trolleys;
- Mr West has remarried while Mrs West has not re-partnered; and
- Mr West has been assessed to pay $146 per week as child support for the two youngest children and he was currently $1732 in arrears of such assessment.

Tax debts are unclear and inconsistent

The Full Family Court commented in *In the Marriage of Biltoft* that:

> A general practice has developed over the years that, in relation to applications pursuant to the provisions of s 79, the court ascertains the value of the property of the parties to a marriage by deducting from the value of their assets the value of their total liabilities.[3]

However, in *Devopoulos and Devopoulos*,[4] the court held that the husband's tax debt of $923,433.46 (which the wife only became aware of after they had been separated for more than 2 years) was *not* to be included in the matrimonial pool of assets and liabilities. The wife received 75% of the net pool of property, with the husband receiving the remaining 25% plus his debt to the Australian Taxation Office (ATO) of $923,433.46.

In *Commissioner of Taxation v Worsnop*,[5] the ATO intervened and advised the court that the husband had a tax debt of some $12 million, including penalties. The court amended its initial orders and ordered that the former matrimonial home valued at $4.75 million be sold and, after the costs of sale, the proceeds be divided equally between the wife and the ATO. The only substantial asset was the home and there was conflicting evidence as to the wife's knowledge of the husband's tax avoidance; however, the trial judge accepted that the wife did not know about the tax debt. The trial judge made no adjustment in favour of the wife for s 75(2) factors although she had the primary care of four children aged between 1 and 13 years and this affected her earning capacity. Her s 75(2) factors were offset against the husband's indebtedness to the ATO as a factor in the Commissioner's favour under s 75(2)(ha).

In the matter of *Lemnos v Lemnos*,[6] the ATO successfully petitioned for a sequestration order against a solicitor from a leading legal firm in Sydney in respect of a significant tax debt, and looked forward to receiving a healthy dividend from the proceeds of a valuable property registered in the sole name of the bankrupt following its sale by the trustee and the deduction of the trustee's modest stipend for administering the bankrupt estate. However, the bankrupt's wife successfully applied to the Family Court for orders that she receive 50% of the net sale proceeds on the basis that the property was matrimonial property and that the *Cummins* principle[7] applied in that even though a property may be registered in the sole name of one of the spouses, prima facie it is jointly owned by the spouses. Accordingly, the expected dividend to the ATO was halved.

Superannuation becoming more of an issue

In bankruptcy, subject to the bankrupt not making any "out of character" payments into his or her super fund prior to bankruptcy with funds that should have gone to creditors, funds held in the bankrupt's super fund at the date of bankruptcy are protected by s 116(2) of the Bankruptcy Act and consequently do not vest in the trustee. Likewise, payments out of the super fund to the bankrupt after the date of bankruptcy are protected.

Conversely, in family law matters, the funds held by the spouses in their respective super funds are now part of the matrimonial property, the value of which is taken into account when the Family Court adjusts the property interests of the spouses.

Furthermore, "splitting orders" can be made whereby the husband's fund, which is generally greater than the wife's, can be "split" into two funds to give the wife a larger super entitlement on retirement.

Also growing in popularity are self-managed super funds operated for the benefit of the spouses by a corporate trustee, and these funds are likewise taken into account when adjusting the spouses' property entitlements. If the corporate trustee does not comply with the

orders of the court regarding the distribution of funds, then the court can make an order winding up the company and appointing a liquidator.

Maintenance and child support

This is one area where we think the legislators have got it right! For example:

- a non-bankrupt spouse who is owed maintenance under a maintenance agreement or order by a bankrupt is entitled to claim as an ordinary unsecured creditor in the bankrupt's estate;
- the bankrupt is required to continue making the periodic payments due under maintenance agreement or order during bankruptcy. To assist them make such payments, s 139N of the Bankruptcy Act prescribes that when a bankruptcy trustee is assessing a bankrupt for income contributions, the bankrupt's taxable income is to be reduced by both the tax payable on such income and the amount payable by the bankrupt in respect of the support of a child pursuant to a maintenance agreement entered into under the Family Law Act, or a maintenance order up to the maximum amount that would be payable under the Child Support (Assessment) Act 1989 (Cth);
- where a bankrupt spouse is receiving maintenance or child support, those amounts are not included in the bankrupt spouse's income for income contribution assessment purposes;[8]
- however, discharge from bankruptcy does not release the spouse from a liability under a maintenance agreement or order incurred prior to the date of bankruptcy;[9]
- while s 153(2A) of the Bankruptcy Act empowers the Federal Court to release a discharged bankrupt from a liability to pay arrears under a maintenance agreement or order, it would be most unusual for the court to make such an order and we are not aware of any such orders being made; and
- furthermore, s 58(5A) of the Bankruptcy Act entitles a non-bankrupt spouse to take recovery action in respect of unpaid maintenance against a bankrupt spouse's property that is not vested in the bankruptcy trustee (eg, superannuation).

Dealing with a spouse's liabilities to creditors

One area that was viewed with some trepidation back in 2005 was the empowerment of the Family Court to transfer, apportion and/or extinguish the liability of a spouse to a creditor.

In the case of where the spouses are jointly liable for a debt and one spouse becomes bankrupt and the Family Court orders that the bankrupt spouse becomes solely liable for the debt, there would be no practical impact on the creditors of the bankrupt spouse, as the extent of his or her liabilities has not changed.

However, if the Family Court ordered that the bankrupt spouse become liable for a debt that the non-bankrupt spouse was previously solely liable for, there will be a significant impact on the bankrupt estate where a partial dividend (less than 100 cents in the dollar) is to be paid to creditors, as the rate of dividend will be reduced with the additional creditor sharing in the distribution.

So far there hasn't been a material swing either way in terms of dealing with such liabilities, and it would appear that those fears have not been realised.

Interaction between insolvency administrations and family law

While we have covered some of the main concepts that are relevant to bankruptcy and family law, we also look at the interaction between insolvency administrations and family law, and consider what has occurred here over the past 10 years or so. From many of the cases mentioned above, it is clear that there have been inconsistencies in the approaches to these matters.

Clearly the time and financial costs of family law proceedings make it very attractive for trustees to consider the utility of mediation or conciliation conferences, and the possibility of making a settlement offer before the issue becomes too entrenched.

To this end, we are often engaged by counsellors to assist in the mediation or negotiation process. These counsellors are engaged by the family lawyers to try and settle areas of personal conflict so that orders can be made. They are finding that a lack of understanding from one party about the other party's business affairs or insolvency affairs is leading to conflict and usually unrealistic expectations, and so we can come in as independent experts to give some explanation of the processes and likely outcomes, or value the business and so on. Again, these misconceptions or misunderstandings are often linked to the different principles operating in both bankruptcy and family law.

Potentially there is some wider scope than may have been originally envisaged — for example, vested bankruptcy property for the purposes of division under s 79 of the Family Law Act. Does this include post-appointment realisations such as money recovered under anti-avoidance provisions? That's a question that so far does not appear to have been raised or considered, but is certainly potentially open to a claim.

Referring back to earlier comments about equitable principles and other principles, the rights and interests of creditors in family law proceedings are considered among the same five-step process that the court adopts

when considering the rights and interests of a party to the relationship. By way of background, that process includes:

1. Should the court make an order altering legal rights?
2. What are the assets, liabilities and financial resources?
3. What are the contributions that each party has made to the acquisition and maintenance of the assets, liabilities and financial resources?
4. Should there be an adjustment to any party based on future needs?
5. Is the division just and equitable?

Those steps have evolved from the court's interpretation of ss 79 and 75(2) of the Family Law Act (or ss 90SM and 90SF(3) of the Family Law Act in cases involving de facto relationships) and were clarified in cases like *Re In the Marriage of Hickey*,[10] and more recently in *Stanford v Stanford.*[11]

The abovementioned sections of the Family Law Act are drafted in a way that enables the court to methodically consider any factor necessary to equitably divide the assets of the parties. This includes blanket protections such as the phrasing of s 79(2) that "the court shall not make an order under this section unless it is satisfied that, in all the circumstances, it is just and equitable to make the order" and also protections relating to third parties such as s 79(10) which allows creditors to become a party to the proceedings, and s 79(11) which provides authority for joining the trustee to a bankruptcy as a party to the proceedings.

While being joined to family law proceedings is an important step for creditors, the case law discussed above shows that it is not an infallible option in circumstances where the court has no real obligation to prioritise the debts owed to a creditor over the financial needs of one or both of the parties to the relationship in the proceedings. In addition, when a creditor is joined as a party to family law proceedings, the court does not have a set approach as to how they handle the consideration of their interests. Historically matters have been approached in the following ways:

- by considering the respective contributions of the parties pursuant to ss 79 and 75(2) of the Family Law Act prior to any bankruptcy issue, making a determination as to how that property should be divided, *then* consider how that division could be altered equitably to repay creditors;[12]
- by repaying creditors at first instance from joint funds of the parties to the relationship, then dividing the remaining assets pursuant to ss 79 and 75(2) of the Family Law Act; or
- by applying some combination of the above two steps.

It is clear from the above that in many cases, the court's evaluation of the contributions of the parties to the relationship can make a distinct difference to the amount that a trustee may stand to receive on behalf of a bankrupt. In a very recent decision in the matter of *Needham and Trustees of Bankrupt Estate of Needham*,[13] the court considered the entitlements of the wife to the matrimonial property in the context of considering the entitlements of the creditors of the husband. It was determined that until the date of separation, the parties had made equal contributions in terms of the considerations set out in s 79(4) of the Family Law Act. However, the court also determined that in the period post separation, the wife's contributions had been substantially greater than those of the husband, but also that she was entitled to an additional adjustment in her favour as a result of her age at 71 years and her limited ability to earn an income.

At first instance, the court ordered that the matrimonial residence worth $3 million be sold and from the net sale proceeds, the wife was to receive 68% less $12,555 and the trustees of the bankrupt husband's estate were to receive the remaining 32% plus $12,555 which represented 32% of the wife's post-separation acquired assets, valued at $40,000 approximately.

The wife successfully appealed with the Full Family Court authorising her to conduct the sale of the property and from the net sale proceeds after payment of all expenses related to the sale, she was to receive 80%, with the trustees of the bankrupt husband's estate to receive the remaining 20% and no further adjustments. The wife gained the additional 18% portion of the net sale proceeds of the house on the basis of the finding that the husband and wife contributed equally during co-habitation, and that 13% should be added in favour of the wife by reason of post-separation contributions and a further 5% by reason of the wife's future needs.

The judgment is useful not only for its detailed review of the contributions made by both parties, but also its comments in relation to the activities of the trustees, especially in regard to the extent of investigation carried out by them to ascertain the bankrupt's assets. The wife contended that the trustees had failed to undertake proper enquiry regarding potential assets of the husband and that the trustees had not attempted to examine the husband under oath. The submission was that the court should make an adjustment in favour of the wife including contemplating that there be no distribution to the trustees who, it was submitted, "stood in the shoes of the husband" in respect to both the husband's non-disclosure and negligent or wanton conduct. In

response, the trustees argued that it was not practicable for them to conduct an examination of the husband, as he had been recalcitrant and refused to say anything to the court or to the trustees, and therefore inappropriate that the trustees should be placed in "the shoes of the husband". It was further submitted that the investigation had limited funds and it was difficult to extend the investigation overseas without sufficient funds.

At first instance, the trustees were held to task for failure to fully disclose all information relevant to the case, in a timely manner. While they argued that they were not a party to the marriage and were not bound by the duty of disclosure set out in Div 13.1.2 of the Family Law Rules 2004 (Cth), the judge was of the opinion that the trustees were subject to Ch 13 of the Rules, including r 13.01, which imposes a "duty to the court and to each other party to give full and frank disclosure of all information relevant to the case, in a timely manner".

However, the Full Court accepted the trustees' submission that further enquiry would have been a futility having regard to the fact that it was a difficult estate that included overseas investigations in circumstances where the husband was wholly uncooperative. The practicality of further investigation, it was argued, also had to be seen in the context of the investigators having limited funds available to pursue such investigations. Furthermore, the Full Court commented that "it is sufficient if all reasonable enquiries are made taking into account the particular circumstances, and the need for proportionality".[14]

Before deciding to get involved in property settlement proceedings, trustees and other parties would be well-advised to consider the list that was created by Federal Magistrate Walters back in 2006, when he presented a well-known paper *Some Aspects of the Interaction of Bankruptcy with Family Law* at the 12th National Family Law Conference in Perth. The list includes the following:

- the court should be mindful of the likely impact of proposed orders upon a creditor's rights, taking into account their legitimate interests, and ensure that they are reasonably necessary, or reasonably appropriate and adapted to effect a just and equitable division of property between the parties;
- whether a party's conduct has been designed to reduce or minimise the value or worth of the matrimonial assets or whether a party has acted recklessly, negligently or wantonly with matrimonial assets, the overall effect of which has reduced or minimised their value;
- the non-bankrupt party's knowledge of events leading up to the other party's bankruptcy, including considerations such as the nature and degree of the non-bankrupt party's involvement and their benefit from or contribution to the bankruptcy;
- when and how the relevant debt was incurred;
- the factual circumstances surrounding the commencement or continuation of property settlement proceedings such as whether:
  - — the relationship has broken down and the parties have separated; and
  - — property settlement proceedings appear to be strategic or tactical to reduce the assets available to the trustee or creditor;
- whether the creditor knew or ought to have known of a potential claim by the non-bankrupt party;
- if and in what manner the creditor pressed or pursued their rights regarding payment of the debt;
- whether, by words or conduct, the creditor or trustee led or permitted the non-bankrupt party to form a reasonable view that the debt would not be pursued or enforced;
- whether, by words or conduct, the non-bankrupt party led or permitted the creditor or trustee to form a reasonable view that their actual or potential entitlements under the Family Law Act would not be pursued or enforced;
- if either of the parties failed to make full and frank disclosure of their financial position at all relevant times;
- whether the trustee has failed to make full and frank disclosure of all relevant information that relates to the identification and valuation of the property comprising the vested interests and provided information relating to the debts;
- the overall financial circumstances of the non-bankrupt party and the children, if any, of the relationship during the period since incurring the debt at the time of proceedings and the effect of the proposed orders;
- whether the debts were incurred before or after separation; and
- whether any party derived any benefit from the debts and the nature and extent of that benefit.

The challenges confronting the parties

A trustee in bankruptcy is not familiar with the matters which the court is required to take into account for the purposes of s 75 of the Family Law Act. Those matters include, but are not limited to:

- age and health;
- income and financial resources;
- care and control of dependants;

- parenting roles; and
- eligibility for pensions or allowances, as well as, of course, any alteration to the interests of a bankruptcy trustee under s 79.

As practitioners, we are not so directly involved with the "emotional baggage" that is inherited with family law matters. Indeed, we try to achieve a commercial monetary result consistent with the duties under s 19 of the Bankruptcy Act, but that is often in conflict with the family law issues.

While the Family Court has jurisdiction to deal with bankruptcy matters as well as other federal monetary disputes such as fraud or voidable transactions, they are foreign creatures to most Family Court, and the provisions in the Family Law Act that deal with those issues often adopt varied methodologies or priorities.

For example, an added complexity in matters that concern a party (or parties) to family law proceedings becoming bankrupt is if the circumstances leading up to that bankruptcy were navigated in a way (either intentionally or otherwise) that enabled one or both of the parties to avoid court orders. Section 106B of the Family Law Act, the section that deals with "transactions to defeat claims", contains provisions specifically relevant to bankrupt parties to family law proceedings.

In the 2013 Family Court case of *Roberts v Pedrana*, Cronin J stated:

> Section 106B(1A) provides that if a party is a bankrupt and the trustee is also a party, the court may set aside a disposition made by the bankrupt which is made to defeat an anticipated order or, similar to s 106B(1), irrespective of intention, is likely to defeat any such order. That obviously focuses on the claim of the trustee of the husband's bankrupt estate.[15]

Cronin J subsequently made orders that the sum of $280,000 that was transferred by the husband to his parents be transferred instead to the trustee, relatively consistent with the orders that the trustee sought from the proceedings. This provision of the Family Law Act is interesting though as it not only protects the trustee appointed in relation to a bankruptcy (if that trustee is a party to the family law proceedings) but can also protect the spouse of a bankrupt party in family law proceedings and any property "claimed back" still forms part of the asset pool to be divided (and does not automatically vest with the trustee).

In addition to growing pains from applying conflicting statutes, there are a number of other issues that parties face when insolvency issues arise as part of family law proceedings. These include:

- Time delays associated with family court proceedings can often be lengthy. At the present time, parties are waiting up to 2 years for hearing dates in NSW registries, sometimes with no interim financial orders made during that time. This then leaves trustees in bankruptcy in potential conflict with their duties and obligations to complete the bankruptcy in a timely and cost effective manner, and in a difficult position with regard to the payment of various creditors.
- The family courts have the ability to consider assets in liabilities in a number of different ways. This includes determining that liabilities should not be included in the joint asset pool (usually due to the date or circumstances those liabilities were accumulated), or that irrespective of their inclusion in the asset pool, they should be assigned to one party with all other parties indemnified from those debts. This can place creditors and trustees in a position where their interests are dealt with in a way that makes the debt less recoverable in the future.
- Family law practitioners may approach the inclusion of the interests of the trustee or creditor as "negotiable", as they would if the parties to a relationship do not agree on the value of various assets and liabilities. The rights and responsibilities for compromising the value of debts and fees for a trustee, however, is dictated under s 134 of the Bankruptcy Act, which again leads to confusion throughout the court process when parties are dealing with their responsibilities under the Bankruptcy Act in competition with the family law process, and their desire to get money to creditors as a matter of priority.

It's not just personal insolvency but corporate as well

There have been a number of cases involving liquidators and the family court, not just bankrupts and their trustees.

Back in 2006, not long after the Bankruptcy and Family Law Legislation Amendment Act 2005 (Cth) came into effect, deVries Tayeh became voluntary administrators and then deed administrators of a group of companies in which the husband (who was bankrupt at the time) and wife were already in family law proceedings. The wife was of the opinion that the administration was a sham and a way of hiding money from any property settlement. Happily for creditors, the judge agreed with evidence that creditors were real and that the family had been living beyond their means for some time, and the liquidators were subsequently awarded costs against the wife, and the return of certain assets. This matter was one of the very first times that costs orders had been issued in a matter that involved family law, corporate insolvency and bankruptcy.

Puddy v Grossvard[16] relates to an appeal against a decision of the Family Court. The liquidator of a company owned and managed by the husband intervened in family law proceedings, seeking repayment of a debt claimed to be owing by the husband to the company of some $500,000. The husband had drawn significant funds from his company, some of which were used in the acquisition of the matrimonial home in proceedings. The trial judge ordered that $250,000 be repaid to the liquidator out of the property settlements, although with a further order that any excess moneys in the liquidation be repaid 75:25 to the husband and wife.

In this appeal, one main argument raised by the appellant was that the trial judge did not have the jurisdiction to entertain the liquidator's claim. However, this argument seems to have been well defeated on a number of grounds including ss 79, 75 and 90AE of the Family Law Act, including where the court may make an order under s 79 binding a third party.

Two of the judges, Warnick and Boland JJ, also made some interesting comments regarding the position of creditors. They agreed there was power within the terms of the Family Law Act to make an order that a party to a marriage pay an amount to a creditor, whether that creditor is a party or not. However, they doubted that there was power to bind a creditor, even if a party to the property settlement proceedings, to accept in satisfaction of a debt, less than the full amount, or to determine the merits and/or quantum of a creditor's claim. They held that:

> … the terms of s 79(10) and s 75(2)(ha) of the Act are directed to the questions of the right to, and the prospect of, recovery by creditors of their debts, [and] not to the proof of those debts, against one … or both of the parties to the marriage, where liability is in issue.[17]

In *Gallieni v Gallieni*,[18] the judge probably went a bit further than usual, not just making the usual property division orders, but ordering the winding up of the company, appointing a liquidator and instructing the liquidator on how to deal with directors and shares, the appointments and transfers of which the court also declared void. Parties were also restrained from submitting any proof of debt in the winding up of the company, and the liquidator was directed to undertake an investigation if necessary into monetary transactions and report back to shareholders. And, to the relief of the liquidator, the court also made orders as to the costs of the liquidator and who was to be responsible for them.

In *D Pty Ltd (In Liq) v Calas (Trustee)*,[19] Moshinsky J of the Federal Court of Australia considered how existing Family Court orders bind individuals and corporations and how these orders should be treated if bankruptcy or liquidation occurs *following* a division of marital interests under s 79 of the Family Law Act.

In that matter, a charge was placed over a property owned by the company, D Pty Ltd (of which the husband was a director), to secure obligations of the husband in compliance with Family Court orders. Liquidators attempted to have that charge put aside on grounds that it was not reasonable for the Family Court to bind the company in that manner. The court held however that the orders were reasonable and appropriate in the circumstances, and therefore declined to lift the charge held over that property.

It's not just companies in liquidation either — in *Southwell and Jane (No 2)*,[20] the corporate trustee of the family trust (of which the husband and his family were beneficiaries and had longstanding unpaid entitlements) was joined to the proceedings after those proceedings had commenced.

In *Kingsley v Kendle*,[21] the Family Court found that the husband, although a bankrupt, had a right to prosecute property proceedings in relation to his superannuation and his personal property because those items are not captured by the bankruptcy to become part of his estate, and that he could participate in other aspects of the property proceedings with the permission of the trustee. The court also granted leave to the husband's parents to be joined to the proceedings on the basis that they claimed to be creditors of the husband and the wife in respect of loans made to them which were used to assist them in purchasing their matrimonial home.

Incidentally, the court in that matter also ordered that the solicitor who was acting for the trustee of the husband's bankrupt estate cease acting for the trustee because he was conflicted because he was a creditor in the bankrupt estate and had been acting for the husband.

Conclusion

It appears that his Honour's comments 20 years ago are still relevant today and that while the legislators with the best intentions have endeavoured to harmonise the two Acts, because of the differences in the basic tenets of each piece of legislation, there will always be difficulties.

Anecdotally, we can see that the financial affairs of the spouses and bankrupts are becoming more complex over time, and continue to pose an increasing challenge to the Family Court judges.

What does that mean for us as insolvency practitioners and family law specialists? Well, more work of course, but also more opportunities to develop better solutions and workarounds as well.

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Footnotes

1. Bankruptcy and Family Law Legislation Amendment Act 2005 (Cth).
2. *West v West* (2007) 38 Fam LR 431; [2007] FMCAfam 681; BC200708335.
3. *In the Marriage of Biltoft* (1995) 19 Fam LR 82 at 91.
4. *Devopoulos and Devopoulos* [2014] FamCA 224; BC201452123.
5. *Commissioner of Taxation v Worsnop* (2009) 40 Fam LR 552; (2009) 74 ATR 401; [2009] FamCAFC 4; BC200950008.
6. *Lemnos v Lemnos* (2007) 38 Fam LR 594; [2007] FamCA 1058; BC200750146.
7. *Trustees of the Property of Cummins (a bankrupt) v Cummins* (2006) 227 CLR 278; (2006) 224 ALR 280; [2006] HCA 6; BC200600981.
8. See Bankruptcy Act, s 139L(1)(b)(i).
9. See Bankruptcy Act, s 153(2)(c).
10. *Re In the Marriage of Hickey* (2003) 30 Fam LR 355; (2003) FLC 93–143—; [2003] FamCA 395.
11. *Stanford v Stanford* (2012) 247 CLR 108; (2012) 293 ALR 70; [2012] HCA 52; BC201208691.
12. See *Parsons v McBain* (2001) 109 FCR 120; (2001) 192 ALR 772; [2001] FCA 376; BC200101460.
13. *Needham and Trustees of Bankrupt Estate of Needham* [2017] FamCAFC 94; BC201750297.
14. Above n 13, at [45].
15. *Roberts v Pedrana* [2013] FamCA 224; BC201350219 at [383].
16. *Puddy v Grossvard* (2010) 237 FLR 340; (2010) 43 Fam LR 288; [2010] FamCAFC 54; BC201050218.
17. Above n 16, at [98].
18. *Gallieni v Gallieni* [2011] FamCA 791; BC201150873.
19. *D Pty Ltd (In Liq) v Calas (Trustee)* (2016) FLC ¶93–751; [2016] FCA 1409; BC201611914.
20. *Southwell and Jane (No 2)* (2011) 52 Fam LR 360; [2011] FamCA 734; BC201111370.
21. *Kingsley v Kendle* [2010] FamCA 598; BC201050673.

Bankruptcy and family law — how, what and why

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Introduction

Ask any practitioner who practises in the family law jurisdiction, and with a resilient sigh and a mop of their brow they will tell you: "Family law is complicated!". Few areas of the law have quite as complex and labyrinthine set of intersections, across a number of different fields of expertise. For example, one matter described under the broad umbrella of "family law" may focus, or at least touch on, complicated issues involving property, commercial, taxation, child support, criminal law, and of course, bankruptcy. Since the introduction of the Commonwealth Family Law Act in 1975 there are few areas of law that have been as perplexing, confusing and unsatisfactory as the intersection between family law and bankruptcy. For a long period of time, until prudent legislative changes were effected in 2005,[1] there was a high degree of uncertainty for both practitioners and litigants as to how bankruptcy could and would affect the process and outcome of their matter.

Context

Before delving into the effect of those legislative changes (the 2005 amendments) it is important not to simply acknowledge the interaction of bankruptcy and family law, but to understand the context in which those interactions take place.

Bankruptcy often occurs with intact marriages, as well as after separation. After separation, bankruptcy may occur at different times and depending on the timing of bankruptcy. There are a number of resoundingly different sets of consequences and outcomes as pointed out by Altobelli J in a paper published in 2005.[2] For example, bankruptcy can occur at the following times:

- before settlement;
- during settlement negotiation;
- during actual litigation;
- before agreed consent orders are made;
- after orders have been made but before implementation;
- after implementation;
- before or after judgment; or
- during an appeal.

Further, the timing of bankruptcy is also impacted by the types of family law issues involved in each matter, be it financial, parenting, child support, maintenance or enforcement.

From a family law practitioner's perspective, the primary aim is to protect the prospective interest of spouse and dependant children, whether there are proceedings on foot or not, or pursuant to a binding financial agreement. However, for bankrupts and their trustees, the aim is to prevent collusion between parties in family law to defeat creditors. Trustees can find themselves in a position of uncertainty when having to resolve or reconcile competing claims.[3]

Legislative action

As previously mentioned, the government has undertaken the complex and difficult task of enacting changes to better deal with outstanding issues, namely the Bankruptcy and Family Law Legislation Amendment Act 2005 (Cth). The 2005 bankruptcy amendments have particular significance for non-bankrupt spouses and the trustee in bankruptcy in circumstances where there are family law property proceedings before the court. The intention of the amendments was to resolve the conflict and competition between the claims of non-bankrupt spouses and the bankrupt's unsecured creditors. Prior to these amendments, when a bankruptcy occurred after a property order was made under the Family Law Act, the non-bankrupt spouse would effectively be left in a position where that property order was treated as if it was never made, and any interest in favour of the non-bankrupt spouse could be clawed back.[4] In circumstances where bankruptcy occurred before family law proceedings, the court had the view that there was no property to attach orders to in favour of the non-bankrupt spouse.[5] Further, in circumstances where a bankrupt's property was vested in the trustee, the non-bankrupt spouse could only recover a share of that property in the event of a surplus after creditors had been paid.

In broad terms, the legislation attempted to solve a number of complex issues, including the following issues.

Jurisdiction

The proposed amendments sought to give the Family Court the ability to deal with matters of bankruptcy concurrently with matters under the Family Law Act. This included an expansion of the definition of "matrimonial cause" to include proceedings between a spouse and the trustee in bankruptcy and the property vested with the trustee. The 2005 amendments gave the Family Court jurisdiction to alter interests in property of a party (with the exclusion of superannuation) that have vested in the trustee in bankruptcy in circumstances of both married and de facto parties under ss 79(1) and 90SM(1) of the Family Law Act. Interestingly however, the wording of the Family Law Act enables the court to make orders to alter property interests in favour of the spouse or de facto parties, but not in favour of the trustee, which would otherwise enlarge the trustee's interest.

The s 79 amendments mean that the trustee can be ordered to settle or transfer what would otherwise be vested bankruptcy property to the non-bankrupt spouse or a child of the marriage: s 79(1). As with maintenance, the bankruptcy trustee can apply to be joined as a party if the court is satisfied that creditors may be affected by the making of an order. If the trustee is joined, the non-bankrupt spouse cannot make submissions to the court except by leave, which can only be granted in exceptional circumstances.

In addition to the added powers under s 79 of the Family Law Act, the 2005 amendments inserted additional provisions under s 75(2), namely that in considering the range of factors to be considered in proceedings: "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".[6] It is somewhat unclear, and still subject to continuing case law analysis, whether the word "creditor" in this context includes the trustee. Thus, creditors' interests stand side-by-side with all of the other factors referred to in s 75(2). No primacy is given to creditors' interests — indeed the wording of s 75(2) leaves open a submission that the weight to be given to this consideration simply depends on the circumstances of each case. Clearly, however, the needs and interests of spouses and their children are considered equal to the needs and interests of creditors.

Finally, as with much recent family law case analyses and discussions, the lingering effects of the decision in *Stanford v Stanford*[7] (*Stanford*) have not yet been tested in the context of bankruptcy. The emphasis in *Stanford* that the court must first identify existing legal and equitable interests may in fact provide some protection for the non-bankrupt spouse where the court would otherwise be identifying the bare legal title only of the parties.

Conflict between non-bankrupt spouse and trustee in bankruptcy

The family law courts now have the power to hear and determine applications in respect of property and spouse maintenance where one party is bankrupt. In these circumstances, the trustee is joined as a party to the proceedings. Effectively, this means that the trustee can then "step into the shoes" of the bankrupt party, and the bankrupt party will not, apart from exceptional circumstances, be permitted to make submissions to the court as it is no longer considered to be the "owner" of assets vested in the trustee.

In addition, there are circumstances where the trustee must be joined to proceedings, namely where the court is satisfied that the interests of the creditors may be affected by an order.

Conflict between trustee in bankruptcy and colluding couples

As indicated earlier, the impact of bankruptcy in family law matters is not simply evident in the process of court proceedings, but can have an impact in circumstances where the matter is resolved without judicial intervention, either by way of consent orders or financial agreements. Importantly, the amendments have put into place protective measures to improve the ability of bankruptcy trustees to collect income contributions, and prevent the use of family law financial agreements as a means of avoiding payment to creditors, and effectively allow the trustee to "claw back" any property transferred prior to the bankruptcy under such an agreement.[8]

An act of bankruptcy will occur when a person is rendered insolvent as a result of assets being transferred under a financial agreement. This means that a person's bankruptcy will be taken to have commenced at the time of the agreement and this will allow the trustee to claim property transferred under the agreement as divisible property in the bankrupt's estate. The net effect of these provisions will be to make transfers of property pursuant to a financial agreement very vulnerable to an application by the trustee for relief. Consent orders will similarly be at risk.[9]

Pursuant to the amendments, the trustee is able to apply to set aside orders, where a spouse is bankrupt at the time the orders were made or becomes bankrupt after the order was made *or* where the order was made with respect to vested property.

Conclusion

In the ensuing years following the amendments, there have been a number of important cases that have tested the interpretation and implementation of these provisions. In a future article, I will detail and explore a

number of these cases to determine whether or not the amendments have adequately resolved the complex interaction between bankruptcy and family law, or whether the time is now right again for further legislative amendment and intervention.

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Footnotes

1. T Altobelli "The bankruptcy and family law revolution" (2005) 18 *Australian Family Lawyer* 1; Bankruptcy and Family Law Legislation Amendment Act 2005 (Cth) supplemented by the Family Law Amendment Act 2005 (Cth).
2. Altobelli, above n 1.
3. Altobelli, above n 1.
4. L Sarmas and B Fehlberg "Bankruptcy and the family home: the impact of recent developments" (2016) 40 *Melbourne University Law Review* 288.
5. Above n 4.
6. Above n 4 at 297.
7. *Stanford v Stanford* (2012) 247 CLR 108; (2012) 293 ALR 70; [2012] HCA 52; BC201208691.
8. Above n 4.
9. G McDonald "Bankruptcy & family law" paper presented at the 2013 Hunter Valley Family Law Conference (25 and 26 October 2013).

Presumably intent

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> Despair ruins some, presumption many.
>
> — Benjamin Franklin

The interaction between family law and bankruptcy is always most difficult in relation to the family home. In the High Court's decision in *Trustees of the Property of Cummins (a bankrupt) v Cummins*[1] (*Cummins*) (which despite its focus on matrimonial assets was not actually a family law case), the High Court adopted a presumption of equal ownership of matrimonial property — at least in the case of what was described as a "traditional matrimonial relationship". However, the full extent to which the High Court's decision has altered existing equitable principles is unclear and has caused confusion since the case was decided.[2]

It is also important to remember that this is merely a *presumption* as to what the parties intended. If there is evidence, which the court accepts, of the *actual* intention of the parties as to who was to own the property, this will take the place of the presumption applied by the case law.

In *Weston v McAuley*[3] (*McAuley)*, the trustee in bankruptcy relied squarely on the presumption in *Cummins* to claim 50% of the proceeds of sale of the matrimonial home. The relevant property was purchased in 1998 as tenants in common — 95% in the name of the wife and 5% in the name of the husband. The husband was an accountant who later became bankrupt. According to Driver J, the "bankrupt may have been a good accountant but he was a poor businessman. He acted in the manner of Mr Micawber".[4] If you are like us, then you may be assisted by knowing that Wilkins Micawber was a character from Charles Dickens's *David Copperfield*, famous for the invaluable financial advice that "something will turn up", and the astute eponymous principle: "Annual income twenty pounds, annual expenditure nineteen pounds nineteen and six, result happiness. Annual income twenty pounds, annual expenditure twenty pounds nought and six, result misery."

In *McAuley*, the parties had been married for 52 years and had owned several properties. The wife had worked in her husband's accounting practice as well as having "raised the children and performed domestic duties".[5] The couple remained together and there were no property settlement proceedings between them. As Driver J noted:

> In the absence of s 79 Family Law Act proceedings brought between the bankrupt and Mrs McAuley there is no scope for the trustee to be heard in the Family Court or this Court on the adjustment of property rights under the Family law Act as between the couple.
>
> In the absence of property proceedings under the Family Law Act, the general law of property applies to assets owned or held by Mrs McAuley and the bankrupt. That includes the application of equitable principles and the provisions of the Bankruptcy Act 1966 (Cth).[6]

Based on the principles set out in *Cummins*, the trustee understandably sought a declaration that the former matrimonial property was in fact owned by the married couple equally, despite the fact that the title was held as tenants in common 95% to the non-bankrupt wife and only 5% to the bankrupt husband.

Driver J accepted the trustee's contention that "unlike all other assets of a marriage, the matrimonial home has a special place in equity for equality between long term married couples".[7]

The court also accepted that in *Cummins* the High Court:

> … overrode the presumption of a resulting trust in favour of the wife in that case that ordinarily would have arisen because of her greater contribution to the acquisition of the matrimonial home.[8]

However, the court distinguished *Cummins* because of:

- the presumption of advancement; and
- the actual intention of the parties.

Presumption of advancement

One of the difficulties of the High Court's decision in *Cummins* has been trying to determine the extent to which it displaces the presumption of advancement. Driver J explained: "What exactly the *Cummins* principle is, and how it affects other traditional equitable trust principles, and in particular the presumption of advancement, is by no means clear."[9]

The presumption of advancement arises in respect of transfers which occur in certain relationships, including transfers from husbands to wives (but not wives to husbands, and not de facto relationships).[10] It is "a presumption that the purchaser intended to give the

other a beneficial interest"[11] and in fact exists as "rather the absence of any reason for assuming that a trust arose or in other words that the equitable right is not at home with the legal title".[12]

However, if the *Cummins* principle meant that a property in a wife's name would still be jointly owned, even if contributions to its purchase were provided by her husband, it was not clear what scope was left for the presumption of advancement.

In an important consideration of this issue Driver J found that the High Court in *Cummins* had *not* abolished the presumption of advancement. Thus "any over payment of the purchase price by the bankrupt was intended to be a gift".[13]

Actual intention

Of course, presumptions are not the final word in the face of actual evidence of a party's intention. Presumptions "may be looked on as the bats of the law, flitting in the twilight, but disappearing in the sunshine of actual facts".[14]

Or if you prefer cricket parlance:

> In reality the so-called presumption of a resulting trust is no more than a long stop to provide the answer when the relevant facts and circumstances fail to yield a solution.[15]

In any event, in *McAuley*, the court was satisfied that the parties had *actually* intended to acquire the property in the interests which they recorded on the title. The evidence demonstrated that:

> … the couple purchased land at various times in joint names or singularly. That history supports an inference that the couple intended that they both should benefit from the properties collectively but does not support an inference that the couple intended any particular property would benefit both of them equally.[16]

This is a challenging conclusion for trustees in bankruptcy who are left to try and reach such inferences from the history of the transactions of the parties to the relationship and who in such a case as this might be forgiven for concluding exactly the opposite — namely (and consistently with *Cummins*) that it did not matter in whose name the title to the property was registered, it was property owned for the joint benefit of the traditional matrimonial relationship.

However, in this case, there was further specific evidence of the wife that was not able to be shaken under cross-examination regarding the husband's previous financial difficulties which included a Pt X Bankruptcy Act agreement with his creditors in 1992 and:

> … several conversations with her husband which established a mutual intention that the property was to be hers completely. In short, having lost her entire investment previously, Mrs McAuley wanted to secure her future.[17]

This intention could not be fully achieved because the bank insisted upon the husband being on the title, but this was "a partial retreat" only. The court found that the presumption of advancement had been bent, but not broken: "Mrs McAuley's reluctant acceptance of the bankrupt's interest in the property weakened but did not eliminate the presumption of her advancement."[18]

Further, the court was satisfied that the mutual intention of Mr and Mrs McAuley "did not in essence change. The property was to be Mrs McAuley's alone to the maximum extent permitted by the bank in the provision of its mortgage and business finance".[19]

Thus, the court was satisfied that there was no resulting trust in favour of the bankrupt and the wife was entitled to retain 95% of the proceeds of the sale of the property.[20]

This case demonstrates the importance of evidence of the parties' *actual* intentions at the time the property is purchased. It confirms that in *Cummins* "the High Court did *not* abolish the presumption of advancement (which, if it had, one would have expected more than what was said [regarding the presumption of equal ownership]".[21]

It also highlights the difficulties for trustees in wading through the murky waters of the various competing presumptions which apply in equity, while avoiding the lurking threat that a credible spouse, whose evidence of actual intentions is accepted, may take the trustee's legal legs out from below.

Unfortunately, the difficulties of dealing with the family property of bankrupt spouses will continue to challenge trustees. Should the law be changed to allow same-sex marriage, there will be a further question regarding the scope of the *Cummins* principle and the traditional matrimonial relationship.

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Footnotes

1. *Trustees of the Property of Cummins (a bankrupt) v Cummins* (2006) 227 CLR 278; (2006) 224 ALR 280; [2006] HCA 6; BC200600981.

2. For instance, see L Sarmas "Trusts, third parties and the family home: six years since Cummins and confusion still reigns" (2012) 36(1) *Melbourne University Law Review* 216.
3. *Weston v McAuley* [2017] FCCA 1; BC201700940.
4. Above n 3, at [91].
5. Above n 3, at [8].
6. Above n 3, at [19]–[20].
7. Above n 3, at [62].
8. Above n 3, at [62].
9. Above n 3, at [50].
10. In R P Meagher and W M C Gummow *Jacobs' Law of Trusts in Australia* (6th edn) Butterworths, Sydney 1997 para 1212, it is described as operating:

    > … where the legal title is, on a purchase, vested in someone whom the person providing the purchase money is under an obligation to support, namely, his wife, child or someone to whom he stands in loco parentis … there is a presumption that the property was vested as an absolute gift or as an advancement.

11. *Calverley v Green* (1984) 155 CLR 242 at 246–47 per Gibbs CJ.
12. *Martin v Martin* (1959) 110 CLR 297 at 303 (quoted in above n 11).
13. Above n 3, at [84].
14. *Mackowik v Kansas City* (1906) 94 SW 256 at 262 per Lamm J.
15. *Vandervell v Inland Revenue Commissioners* [1967] 2 AC 291 at 313 per Lord Upjohn, cited by Mason P (with whom McColl and Basten JJA agreed) in *Neilson v Letch (No 2)* [2006] NSWCA 254; BC200607595 at [27].
16. Above n 3, at [89].
17. Above n 3, at [92].
18. Above n 3, at [94].
19. Above n 3, at [94].
20. Above n 3, at [96].
21. Above n 3, at [82].

Bankruptcy and the world of family law

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Since the "marriage" of bankruptcy and family law in 2005,[1] matters between a trustee in bankruptcy and a non-bankrupt spouse fall within the jurisdiction of the Family Court of Australia and the Federal Circuit Court.[2] This union is framed in uncertainty and is often far from harmonious.

Bankruptcy and family breakdown have but one similarity, namely falling within the legislative powers of the federal government,[3] yet are required to meaningfully co-exist to determine the competing claims of creditors against the needs of the spouse and family. Bankruptcy law is known for strict compliance with rules and regulations while a feature of the family law arena is broad judicial discretion in applying the law to the particular facts of a case.

This article considers the framework under the Family Law Act 1975 (Cth) (the Act) for property matters, challenges for a trustee within such framework and the role of dispute resolution to navigate competing interests and explore settlement options rather than risk the uncertainty of a judicial determination.

Legislative framework

Property vested in a trustee under the Bankruptcy Act 1966 (Cth) is subject to orders under the Act.[4] Understanding the Family Court's approach when determining what, if any, order will be made for an adjustment of "property" for married couples[5] or de facto spouses[6] and where creditors stand in such determination is critical for a trustee. For married couples, s 79(1) of the Act[7] gives the court power to make an order adjusting property interests (property order) as it deems appropriate. Since 2005, this includes power to make an order altering the interests of a trustee in the vested bankruptcy property as set out in the following subsections:

> …
> (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.

In its determination of such an order, the court is required under the Act to consider a number of matters including a variety of "contributions",[8] the effect of a proposed order on the earning capacity of a party,[9] and relevant factors under s 75(2)[10] of the Act (referred to by family lawyers as the "future needs" of a party). The matters under s 75(2)(a) to (q) are far-reaching with the need to balance the interests of the creditors with the non-bankrupt spouse recognised in subs (n) in that the court is to consider:

> (n) the terms of any order made or proposed to be made under section 79 in relation to:
> (i) the property of the parties; or
> (ii) vested bankruptcy property in relation to a bankrupt party.[11]

Further, s 75(2)(ha) of the Act requires the court to consider 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.

In *Trustee of the Property of Lemnos v Lemnos*,[12] the Full Court of the Family Court of Australia held that:

> … the effect of the 2005 amendments … is that the interests of unsecured creditors do not automatically prevail over the interests of the non-bankrupt spouse and that the legislation requires the court to balance their competing claims in the exercise of the wide discretion conferred by s 79.[13]

Tension understandably exists in considering how to achieve such balance particularly where the non-bankrupt spouse has dependent children, may have limited earning capacity and/or be in poor health. The interest of creditors is but only one of a long list of matters to be considered and may be at odds with providing for the needs of the non-bankrupt family members.

Role of the trustee in court proceedings

Under the Act, a trustee does not wholly stand in the shoes of a person prior to bankruptcy. As stated by Jacqueline Campbell and Evelyn Young:[14]

> A trustee cannot institute s 79 proceedings against a non-bankrupt spouse as a means of trying to enlarge the assets in the bankrupt estate available for creditors whereas

> a non-bankrupt spouse can bring a s 79 application to try to increase their entitlements by claiming against property which has vested in the trustee.

While a limitation exists in commencing property proceedings, a trustee can apply to be joined as a party and if the court is satisfied the interests of the creditors may be affected by an order, the court *must join* the trustee to the proceedings.[15]

Another limitation is the ambit of "property" subject to an order under the Act. While property between non-bankrupt parties is all-encompassing of assets and financial resources, this is not the case for property that "vests" in the trustee. Limited access to superannuation, financial resources and assets held on trust is a reality of the reduced financial pool available to the trustee for the benefit of creditors. In recognising such limitations, his Honour Altobelli J commented: "The trustee has extensive remedies outside the Family Law Act including all of the anti-avoidance and claw-back provisions of the Bankruptcy Act as well as equitable principles."[16]

The Full Court of the Family Court reaffirmed the position of trustees and the power of the court in *Needham and Trustees of Bankrupt Estate of Needham* (*Needham*) in confirming the following statement of the trial judge:

> A point of distinction, in circumstances where a party to the marriage has become bankrupt, is the fact that subsection 79(1)(b) empowers the Court to make an order altering the interests of the Official Trustee in Bankruptcy "… in the vested bankruptcy property." This is in contrast to the Court's general power, where bankruptcy is not an issue, to alter the interests of the parties in the property of the marriage. The jurisdiction granted by the 2005 Amendment Act therefore enables a Trustee to join proceedings for the purpose of resisting claims by a non-bankrupt spouse to vested bankruptcy property. The legislation does not, however, empower the Respondent Trustees to utilise the provisions of the [Act] to enlarge the vested bankruptcy property available to the bankrupt spouse's creditors.[17]

So as a consequence of the 2005 "marriage", not only is a trustee catapulted into a legal framework distinguished by wide discretion, required to counter arguments of interests, needs and concerns of the non-bankrupt spouse and family, but has limited access to property in order to satisfy creditors. Is dispute resolution a viable avenue for a trustee in meeting such challenges?

Dispute resolution

Separated parties are required to engage in pre-action procedures before filing an application with the court seeking orders for an adjustment of property.[18] The aim of the pre-action procedures is to explore areas of resolution and, where a dispute cannot be resolved, to narrow the issues that require a court decision. This should control costs, and if possible, resolve disputes quickly, ideally without the need to apply to a court.[19]

Parties are required to invite the other party to engage in dispute resolution, agree on and attend the dispute resolution process, and if appropriate exchange correspondence on issues.[20] Parties are also obliged to make a full and frank disclosure of their financial situation and provide specified documents to the other party.[21] Interestingly, the pre-action procedures do not apply to cases where a party to the marriage or de facto relationship is bankrupt.[22] Is this a lost opportunity for the trustee and non-bankrupt spouse to engage in discussion?

Dispute resolution is an umbrella term for different processes ranging from informal without prejudice discussions, collaborative practice that embraces interest-based negotiation where parties "contract" not to go to court, to formal mediation and arbitration. A dispute resolution process provides a forum to exchange information, explore options to settle competing interests in a timely manner and reduce costs. Importantly, a negotiated outcome gives all parties certainty of outcome. A consideration of *Needham* raises questions regarding the usefulness of dispute resolution in matters involving a trustee and non-bankrupt spouse. In that case, the wife appealed to the Full Court of the Family Court of Australia from final property orders made on 20 April 2016 by McClelland J. The facts stated that the husband and wife married in 1985, separated in May 1999 and divorced in December 2006. On 16 February 2015, the husband was declared bankrupt and the trustees became respondents in the proceedings under s 79(11). It was agreed between the parties at trial that the husband's bankruptcy occurred as a result of his actions after separation.[23] The orders at first instance included provision for the sale of the former matrimonial home with a division of 68% to the wife (less $12,555) and 32% to the trustees (plus $12,555). The sum of $12,555 represented 32% of the wife's post-separation acquired assets. At the time of the trial, the wife was 71 years of age and the husband was 73 years of age.

In reaching his determination, McClelland J set out his consideration of the matters under ss 79 and 75(2) of the Act stating:

> I have also determined that the wife is entitled to an additional adjustment in her favour as a result of relevant section 75(2) factors. This includes, most relevantly, the fact that the wife is 71 years of age and has a limited ability to continue to earn an income.
>
> In considering the matters set out in sections 79(4) and 75(2), I have had regard to the interests of creditors of the husband and specifically, the fact that any distribution in favour of the wife would result in those creditors receiving a smaller recovery from the vested bankruptcy property of the husband.[24]

The Full Court determined the trial judge had erred in the exercise of discretion, concluding that there had been a failure to take into account material considerations.[25] The appeal was allowed with the Full Court exercising its discretion ordering the net proceeds of sale (after various stated expenses) to be distributed as to 80% to the wife and 20% to the trustees.

Several interesting points are identified from the Full Court judgment:

- that the trustees were subject to the obligations of full and frank disclosure under r 13.04 of the Family Law Rules 2004 (Cth);[26]
- the obligation for full and frank disclosure did not, in that case, require the trustees to undertake an examination of the husband pursuant to s 81 of the Bankruptcy Act, the Full Court noting the finding of the trial judge that:

  > … "mere speculation" that there were other assets was not enough … Trustees had "acted appropriately" to provide full and frank disclosure of the assets and … "evidence falls short of establishing, on the balance of probabilities, that the husband has additional interests that should be included in the matrimonial property pool";[27]

- personal and post-separation assets of the wife should not have formed part of the asset pool;[28] and
- appropriate consideration and weight was not given to certain "contributions" by the wife and a failure to take into account material considerations.[29]

One is left wondering if an early dispute resolution process may have assisted the parties in *Needham* to reach an alternate outcome. The cost to the trustee, and ultimately to the creditors, reaches beyond the reduced moneys from the sale proceeds. Legal fees and the time of the various court processes are real and relevant factors.

Actively engaging the non-bankrupt spouse in a dispute resolution process provides a forum for full and frank disclosure, informed settlement discussions and the opportunity to explore options that, while possibly not meeting all parties' interests and needs, will provide certainty of outcome and reduced costs. The discretionary nature of family law does little to provide a trustee with confidence in a court-determined outcome. Even though pre-action procedures do not apply, dispute resolution is a feature of the Family Court with parties required to attend a conciliation conference with a registrar of the court,[30] including the trustee if made a party in the proceedings, and encouraged to explore all opportunities to settle. The trustee may be ordered to provide a report to the court and this can be the basis of meaningful discussions with the non-bankrupt spouse.

Tips for trustees

In matters involving a non-bankrupt spouse, the following "tips" may assist a trustee:

- Contact the non-bankrupt spouse or their legal representative and be prepared to engage effectively in settlement discussions early in the matter notwithstanding pre-action procedures do not apply.
- Explore the various dispute resolution processes of:
  - — without prejudice negotiation meetings;
  - — mediation;
  - — collaboration; and
  - — arbitration.
- Provide a full and frank disclosure of information on the bankrupt party including what, if any, attempts have been made to identify and acquire assets of the bankrupt.
- Be proactive in preparing a report as envisaged under r 26.24 and provide to the non-bankrupt spouse.
- Gain an understanding of the situation for the non-bankrupt spouse, in particular the relevant matters concerning future needs.
- Be prepared to compromise as certainty of outcome may be preferable to a court-ordered determination.

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Footnotes

1. Bankruptcy and Family Law Legislation Amendment Act 2005 (Cth).
2. For the purpose of the article the generic term "Family Court" will be used and applies to the jurisdiction of Family Court of Australia and Federal Circuit Court.
3. Australian Constitution, s 51(xvii) and (xxii).
4. Bankruptcy Act, s 59A.
5. Family Law Act, s 79.
6. Family Law Act, s 90SM.
7. As to de facto spouses, see Family Law Act, s 90SM.
8. Family Law Act, s 79(4) (married couples) and s 90SM(4) (de facto spouses).
9. Family Law Act, s 79(4)(d) (married couples) and s 90SM(4)(d) (de facto spouses).
10. As to de facto spouses, see Family Law Act, s 90SF(3).

11. As to de facto spouses, see Family Law Act, s 90SF(3)(n).
12. *Trustee of the Property of Lemnos v Lemnos* (2009) 223 FLR 53; (2009) 41 Fam LR 120; [2009] FamCAFC 20; BC200950043.
13. Above n 12, at [200] per Thackray and Ryan JJ.
14. J Campbell and E Young "Stanford, bankruptcy and unsecured liabilities — options and opportunities" (2015) 24(2) *Australian Family Lawyer* 1.
15. Family Law Act, s 79(1)–(10) (emphasis added) and s 90SM(1)–(14) for de facto spouses.
16. T Altobelli "The bankruptcy and family law revolution" (2005) 18 *Australian Family Lawyer* 1 at 3.
17. *Needham and Trustees of Bankrupt Estate of Needham* [2017] FamCAFC 94; BC201750297 at [42].
18. Family Law Rules 2004 (Cth), r 1.05.
19. Family Court of Australia, *Before you file — pre-action procedure for financial cases*, 19 June 2009, www.familycourt.gov.au/wps/wcm/connect/fcoaweb/reports-and-publications/publications/getting-ready-for-court/before-you-file-pre-action-procedure-for-financial-cases-%28prescribed-brochure%29.
20. Above n 19.
21. Family Law Rules, Sch 1.
22. Family Law Rules, r 1.05(2)(h).
23. Above n 17, at [6].
24. *Needham and Trustees of Bankrupt Estate of Needham* [2016] FamCA 253; BC201650288 at [3]–[4].
25. Above n 17, at [30].
26. Above n 17, at [38]–[39].
27. Above n 17, at [41].
28. Above n 17, at [34].
29. Above n 17, at [30].
30. Family Law Rules, r 12.07.

Impugning a binding financial agreement as an unreasonable director-related transaction

Peter Leech *COWELL CLARKE*

Introduction

This article considers the decision of Edmonds J in *Kijurina (as Liquidator of ET Family Pty Ltd) v Taouk*[1] (*Kijurina*), placing particular emphasis on the interaction between the Corporations Act 2001 (Cth) (CA) s 588FDA and the scope given to spouses to enter into binding financial agreements as provided for in Pt VIIIA of the Family Law Act 1975 (Cth) (FLA).

Binding financial agreements

The FLA allows spouses to enter into a financial agreement with respect to certain subject matters (broadly, how property of either or both spouses is to be dealt with and maintenance of either of the spouse parties)[2] known commonly as a "binding financial agreement" (BFA) which can exclude the jurisdiction of the Family Court to make orders as between the spouses concerning those matters.[3] A BFA may also contain matters incidental or ancillary to property division and maintenance and "other matters".[4]

To exclude the jurisdiction of the Family Court, an agreement must be enforceable at law and must also comply with criteria set out in the FLA (which include a requirement to obtain independent legal advice).[5] Similar provisions allow de facto spouses to enter into financial agreements with similar effect.[6]

The provisions recognise that "the parties to the marriage may make the financial agreement with one or more other people".[7] A BFA may be enforced by application to the Family Court.[8]

Proceedings may be brought pursuant to s 90K of the FLA to set aside or terminate a BFA if the court is satisfied that (relevantly):

- a party to the agreement entered the agreement for the purpose of defrauding or defeating a creditor, or with reckless disregard for the interests of a creditor (s 90K(1)(aa)); or
- the agreement is void, voidable or unenforceable (s 90K(1)(b)).

Section 90K of the FLA does not identify who may apply pursuant to s 90K, meaning it is necessary to look to the coverage and definitions sections of the FLA.

Section 8(1) of the FLA states that:

> (1) After the commencement of this Act:
>
> (a) proceedings by way of a matrimonial cause shall not be instituted except under this Act …

In s 4 of the FLA, the term "matrimonial cause" includes:

- proceedings with respect to a financial agreement that are between any combination of:
  - — the parties to that agreement; and
  - — the legal personal representatives of any of those parties who have died (including a combination consisting solely of parties or consisting solely of representatives);[9] or
- third party proceedings (as defined in s 4A) to set aside a financial agreement.[10]

By s 4A, "third party proceedings" are proceedings between:

> (a) any combination of:
>
> (i) the parties to a financial agreement; and
>
> (ii) the legal personal representatives of any of those parties who have died; (including a combination consisting solely of parties or consisting solely of representatives); and
>
> (b) any of the following:
>
> (i) a creditor;
>
> (ii) if a creditor is an individual who has died — the legal personal representative of the creditor;
>
> (iii) a government body acting in the interests of a creditor;
>
> being proceedings for the setting aside of the financial agreement on the ground specified in paragraph 90K(1)(aa).

For the purposes of s 4A of the FLA, "creditor" takes in both a creditor of a party to a BFA and also a person who, at the commencement of the proceedings, could reasonably have been foreseen by the court as being reasonably likely to become a creditor of a party to a BFA.[11]

The term "government body acting in the interests of a creditor" is not defined, though "government body" is defined in s 4B(4) as:

> (a) the Commonwealth, a State or a Territory; or

(b) an official or authority of the Commonwealth, a State or a Territory.

This excludes a liquidator or private trustee in bankruptcy. The Full Court of the Family Court of Australia has also determined that the words "government body" do not take in the Official Trustee in Bankruptcy, as it is not an "official or authority", but rather, pursuant to s 18 of the Bankruptcy Act, a body corporate.[12]

The only government body acting in the interests of a creditor clearly contemplated by s 4A of the FLA is the Australian Securities and Investments Commission (ASIC). While it is clear why this is the case (based on parliament's wish to address the dismissal on the basis of lack of standing of ASIC's application in the case of *ASIC v Rich*[13]),[14] it is puzzling that ASIC has a right of action, yet liquidators and trustees in bankruptcy do not.

Finally, in any event the "bar" set, before a BFA will be set aside pursuant to s 90K(1)(aa) of the FLA, is high, requiring proof of an intention to defraud or defeat a creditor or reckless disregard of the interests of a creditor.

Unreasonable director-related transactions

In 2003, also prompted by the collapse of One.Tel,[15] the voidable transactions sections of the CA were amended to include grounds of recovery known as "unreasonable director-related transactions". Only certain types of transactions can be potentially caught, namely a payment, a disposition of property, the issuing of securities or the incurring of an obligation to do one of these things.

A transaction will be caught even if it gives effect to a court order or direction by an agency, but entry of a consent order does not, in itself, amount to a transaction "of the company".[16]

To attract the operation of the provisions, the payment, disposition of property or issue of securities must have been made, or is to be made, to a class of persons including a director of the company or a close associate of a director. A spouse of a director is clearly a close associate for these purposes.[17]

The transaction must have occurred in the period of 4 years ending on the relation-back day or after the relation-back day and on or before the day when the winding up began.

For an order to be made, it must be demonstrated that "a reasonable person in the company's circumstances would not have entered into the transaction", having regard to:[18]

- the benefits (if any) to the company of entering into the transaction;
- the detriment to the company of entering into the transaction;
- the respective benefits to other parties of entering into the transaction; and
- any other relevant matter.

The test is applied when the transaction (for example the making of a payment) is entered into rather than when the obligation to enter into it is incurred.[19] There is no requirement to show the company was insolvent at any point. The test is not as difficult to satisfy as the test in s 90K of the FLA. Only a liquidator may issue a claim based on the provisions.[20]

The facts in Kijurina

Mr Taouk was the sole director, secretary and shareholder of two companies, ET Family Pty Ltd and MEA Group (Companies). Each of the Companies was the registered proprietor of certain real property (Land).

Mr Taouk and Mrs Taouk on or around 3 September 2013 entered into a BFA which identified:

- taxation liabilities of the Companies under the heading of "liabilities"; and
- the Land as falling within the assets to be transferred to Mrs Taouk.

On or about 26 September 2013, Mr Taouk caused the Companies to transfer the Land to Mrs Taouk for consideration identified as "pursuant to s 90C Family Law Act 1975".

On 11 October 2013, the Companies were placed into voluntary liquidation.

Mrs Taouk subsequently offered the Land as security for loan facilities obtained from a bank. Mr Taouk received $548,435 from the proceeds of the loans.

The reasoning of Edmonds J

The liquidators' proceedings initially named Mrs Taouk and the bank as defendants, but those claims were resolved before trial. Mr Taouk had been involved at an earlier stage but was not represented at the final hearing.[21]

The claim against Mr Taouk pursuant to s 588FDA was that the relevant "transactions" "included", or were "either or both of", the transfers and, importantly, also entry into the BFA itself.[22] While not stated explicitly, this suggests that the Companies were parties to the BFA.

Mrs Taouk was clearly a close associate of Mr Taouk. The transfer of the Land to her by the Companies fell within the classes of transactions caught by the provisions. In each case, the court found that in all of the circumstances a reasonable person in the Companies' position would not have transferred the Land having regard in particular to the financial position of each of the Companies, which after the transfers had substantial debts and no assets to realise in order to pay them.[23]

In each case, the court made declarations that the transfers to Mrs Taouk were unreasonable director-related transactions. The remedies ordered, however, were limited to orders under s 588FF(1)(c) of the CA, requiring payment by Mr Taouk to the Companies of amounts equal to the value of the Land at the date of the transfers.

Notably, the liquidators did not seek to have the transfers or the BFA declared void pursuant to s 588FF(1)(h) of the CA.

Discussion — the interaction between the CA and FLA

A question raised by the reasons of Edmonds J is whether Mr Taouk could have disputed that the Federal Court had jurisdiction to deal with the liquidators' application pursuant to s 588FDA(1) of the CA on the basis that, to the extent it sought to rely upon the Companies' entry into the BFA, it amounted to a "matrimonial cause", and thus was a question which had to be dealt with exclusively by reference to the FLA.

It is submitted that resistance of the application on this basis would have failed in that while the claim would amount to proceedings with respect to a financial agreement, the liquidators (as opposed to the Companies) were not parties to the BFA.

Interestingly, the liquidators in *Kijurina* also caused the Companies to make claims against Mr Taouk alleging breaches of his statutory and fiduciary duties. It is not clear from the report whether the liquidator pleaded that by entering into the BFA Mr Taouk was said to have breached his duties. Edmonds J disposed of the question summarily, apparently on the basis that the transfer of the Land occurred in circumstances in which it conferred an unreasonable benefit to Mr Taouk to the extent of the market value of the Land at the date of the transfers.[24]

It seems possible that Mr Taouk could have successfully argued that this claim should have been stayed or dismissed on the basis that the subject matter of such a claim meant it is a matrimonial cause within the meaning of the FLA and therefore lies in the exclusive jurisdiction of the Family Court as such a claim was "with respect to"[25] a BFA between the parties to that BFA (relevantly, the Companies, Mr Taouk and Mrs Taouk).

Given this risk, it may follow that, in situations in which a claim based on s 588FDA(1) of the CA is not available (for example, if the 3-year time limit from the relation-back day has expired),[26] a liquidator would be limited to pursuing relief available under the FLA and in particular s 90K.[27]

A claim based on s 90K(1)(aa) of the FLA, given the mental element as to the parties' purpose which needs to be shown, will be more difficult to make out than either a claim pursuant to s 588FDA of the CA or a claim for damages alleging breaches of statutory and fiduciary duties. Accordingly, absent evidence as to the parties' mental state in causing a company to become party to a BFA, a liquidator's best option in such cases may be proceedings pursuant to s 90K(1)(b) of the FLA seeking orders that a BFA is "void, voidable or unenforceable".

The question of whether a BFA is void, voidable or unenforceable is determined by the Family Court by reference to the general law relating to contracts and principles of equity.[28] A difficulty, however, is that even if a director has breached his or her fiduciary duties in causing a company to enter into a contract (meaning the contract is voidable at the company's election) and the company purports to rescind that contract, a court will not give effect to the avoidance if the rights of innocent third parties would be affected.[29]

This limitation could lead to significant hurdles to recovery being erected in marriage breakdown cases. By way of simple example a married person may have significant assets invested in a private company developing home units. The spouses may agree in a BFA that in the event of a breakdown the spouse not involved in the business would be entitled to ownership of a unit in return for relinquishing claims against the other spouse (the company can be a party to the BFA to effectuate this). The marriage may then break down, the development is completed and pursuant to the FLA the relevant spouse is registered as owner of a unit. It is possible that this spouse will subsequently take out a bank loan to assist with living expenses and grant a mortgage over the unit as security. At this point, up to 4 years later, the company would become insolvent.

Given the applicable principles applying to equitable relief it is difficult to see the Family Court ordering pursuant to s 90K(1)(b) that the spouse who did not work in the business reconvey unencumbered title to the unit, even if it is shown that the other spouse breached fiduciary duties owed to the company in causing the company to enter into the BFA.

Conclusion

The ability of companies to be parties to BFAs presents challenges to liquidators. In considering what recovery options may be available, it is important to first determine whether a potential ground of recovery will fall within the subject matter over which the FLA has exclusive jurisdiction. As demonstrated by the *Kijurina* case, a liquidator will have the best chance of making at least some recovery in connection with transfer of assets of a company pursuant to a BFA in circumstances in which the criteria for a claim under s 588FDA of the CA are made out.

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Footnotes

1. *Kijurina (as Liquidator of ET Family Pty Ltd) v Taouk* (2015) 105 ACSR 686; [2015] FCA 424; BC201503581.
2. FLA, s 90C(2).
3. FLA, s 71A(1).
4. FLA, s 90C(3).
5. FLA, s 90G.
6. FLA, Pt VIIIAB, Div 4.
7. FLA, s 90C(1).
8. FLA, s 90G(2).
9. FLA, s 4(eaa) (matrimonial cause).
10. FLA, s 4(eab) (matrimonial cause).
11. FLA, s 4A(2).
12. *Official Trustee in Bankruptcy and Galanis* (2017) 318 FLR 22; [2017] FamCAFC 20; BC201750082 at [59]–[67].
13. *ASIC v Rich* (2003) 181 FLR 181; (2003) 31 Fam LR 667; [2003] FamCA 1114.
14. Supplementary Explanatory Memorandum, Family Law Amendment Bill 2003 (Cth).
15. Commonwealth, *Parliamentary Debates Second Reading Speech to the Corporations Amendment (Repayment of Directors' Bonuses) Bill 2002 (Cth)*, House of Representatives, 16 October 2002.
16. *D Pty Ltd (In Liq) v Calas (Trustee)* (2016) FLC ¶93–751; [2016] FCA 1409; BC201611914 at [82].
17. CA, s 9, "close associate" and "relative".
18. CA, s 588FDA(1).
19. CA, s 588FDA(2).
20. CA, s 588FF(1). This type of claim may now be assigned by a liquidator pursuant to CA, Sch 2, s 100–5.
21. Above n 1, at [4].
22. Above n 1, at [46] and [55].
23. Above n 1, at [49] and [56].
24. Above n 1, at [92]–[93].
25. Courts have given the phrase "with respect to" a wide meaning. In *O'Grady v Northern Queensland Co Ltd* (1990) 169 CLR 356 at 376, McHugh J stated that it "requires no more than a relationship, whether direct or indirect, between [the] two subject matters".
26. CA, s 588FF(3).
27. FLA, s 90K(1) sets out the only bases upon which a BFA may be set aside.
28. FLA, s 90KA.
29. R Austin and I Ramsay *Ford, Austin and Ramsay's Principles of Corporations Law* (16th edn) LexisNexis, 2015 para 9.360.

Consent orders in the Family Court and unreasonable director-related transactions under s 588FDA of the Corporations Act 2001: D Pty Ltd (In Liq) v Calas (Trustee)

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Introduction

In this issue, Peter Leech has discussed the case of *Kijurina (as Liquidator of ET Family Pty Ltd) v Taouk*[1] (*Kijurina*) as to whether a binding financial agreement under the Family Law Act 1975 (Cth) was an unreasonable director-related transaction. In the latter case of *D Pty Ltd (In Liq) v Calas (Trustee)*,[2] the Federal Court considered whether a charge over property of a company as security for obligations of a husband under an agreement embodied in a consent order approved under the Family Law Act could be an "unreasonable director-related transaction" which could be impugned by the liquidator of the company.

Facts

In July 2012, the wife (second defendant) commenced proceedings against her husband (third defendant) in the Family Court for property adjustment orders under the Family Law Act. She joined her brother-in-law and four companies associated with the husband and brother-in-law, including D Pty Ltd.

On 4 December 2012, the husband and wife signed minutes of a proposed consent order, and these were not signed by D Pty Ltd.

On 7 December 2012, the Family Court made consent orders, which included an order that the husband pay $500,000 into a trust account for the wife, $300,000 of which was to come from sale of property owned by C Pty Ltd, and any shortfall to be paid from the proceeds of sale of a particular property owned by D Pty Ltd. The money was to be used by the husband to develop and purchase a house for his wife and child, to be registered in her name and eventually it would vest absolutely in the wife on the child reaching 30.

The sole shareholder of D Pty Ltd was C Pty Ltd, and the sole shareholder of C Pty Ltd was the brother-in-law. D Pty Ltd was trustee of a discretionary trust and in that capacity owned the property in question which was the subject of the consent order.

On 10 July 2014, the wife brought family proceedings to enforce the consent orders. On 9 August 2014, the wife was made bankrupt and the first defendant was appointed trustee. On 22 August 2014, D Pty Ltd went into liquidation and the plaintiff was sole liquidator at the date of the hearing.

The liquidator sold the property owned by D Pty Ltd and retained the proceeds.

On 9 December 2015, the Family Court gave judgment on the wife's July enforcement application: *Megalos and Katsaros*.[3] Benjamin J held that the consent orders provided for an equitable charge and/or lien over the property owned by D Pty Ltd to secure the shortfall of the amount to be paid into trust by the husband. The liquidator took the property subject to the wife's equitable interest. The Family Court therefore declared that all the moneys received by the liquidator for the property were held on trust for the trustee in bankruptcy as trustee for the wife's estate.

Federal Court proceedings by the liquidator

The liquidator initially contended that there was charge by D Pty Ltd over the property as contained in the minutes of the consent order, which amounted to a voidable transaction and uncommercial transaction. However, the court accepted an amendment which replaced this pleading with a claim that it was an unreasonable director-related transaction and that the charge was void and/or unenforceable. This meant that it was no longer necessary to show that D Pty Ltd was insolvent at the time of, or as a consequence of, the transaction.

The husband and brother-in-law did not participate in the litigation and essentially this was a dispute between the liquidator of D Pty Ltd and the wife's trustee in bankruptcy. The trustee in bankruptcy argued that:

- the terms of the court consent order and the proposed minutes of consent order were different;
- D Pty Ltd was a party to the Family Court proceeding and the consent orders were lawfully and reasonably made against D Pty Ltd and its property; and

- the Family Law Act would prevail over the Corporations Act 2001 (Cth) to the extent of any inconsistency.

Relevant provisions

Section 588FDA is contained in Pt 5.7B of the Corporations Act and states that a transaction is an unreasonable director-related transaction of the company if, and only if:

> (a) the transaction is:
> (i) a payment made by the company; or
> (ii) a conveyance, transfer or other disposition by the company of property of the company; or
> (iii) the issue of securities by the company; or
> (iv) the incurring by the company of an obligation to make such a payment, disposition or issue; and
> (b) the payment, disposition or issue is, or is to be, made to:
> (i) a director of the company; or
> (ii) a close associate of a director of the company; or
> (iii) a person on behalf of, or for the benefit of, a person mentioned in subparagraph (i) or (ii); and
> (c) it may be expected that a reasonable person in the company's circumstances would not have entered into the transaction, having regard to:
> (i) the benefits (if any) to the company of entering into the transaction; and
> (ii) the detriment to the company of entering into the transaction; and
> (iii) the respective benefits to other parties to the transaction of entering into it; and
> (iv) any other relevant matter.

That test applies to dispositions as at the time the transaction is entered into, rather than when the obligation was incurred.

Subsection (3) states that:

- it is not necessary for a creditor to be a party to such a transaction; and
- even if the transaction is given effect to, or is required to be given effect to, because of an order of an Australian court or direction of an agency, it will still fall within s 588FDA(1).

Section 9 of the Corporations Act defines "close associate" as meaning a relative of the director, or of the spouse of the director. "Transaction" includes, as an example, "a security interest granted by the body in its property" and "an obligation incurred by the body".

Judgment of Moshinsky J

His Honour noted that s 588FDA substantially adopts the language of s 588FB (Uncommercial transactions) and that in relation to the latter, authors of *Ford, Austin and Ramsay's Principles of Corporations Law*[4] observe that the purpose of the provision is to prevent a depletion of assets of a company which is being wound up by certain transactions entered into within a specified limited time before the winding up. In *Crowe-Maxwell v Frost*,[5] it was stated that this applied to s 588FDA too.

In *Crowe-Maxwell v Frost*, Beazley P adopted the principles in *Smith v Starke Re Action Paintball Games Pty Ltd (in Liq) (No 2)*.[6] The inquiry under s 588FDA(1)(c) is as to the following:

- the reasonableness of the company's conduct, objectively assessed by reference to the company's circumstances and all relevant matters;
- normal commercial practice is relevant but not determinative; and
- a transaction of derivative benefit only can still be for the benefit of the company.

Beazley P cited with approval *Weaver v Harburn*[7] (*Weaver*) and *Vasudevan (as Joint and Several Liquidator of Wulguru Retail Investments Pty Ltd) (in liq) v Becon Constructions (Australia) Pty Ltd*[8] (*Vasudevan*). In *Weaver*, it was said that the only insolvency-related aspects to s 588FDA are the fact that the company is in liquidation and that the transaction was entered into within 4 years prior to that event. Otherwise, the relevance and weight of insolvency depends on the facts. *Vasudevan* stressed that, in keeping with the objective of the section, "benefit" was not to be confined to something in the nature of an equitable interest. Beazley P also stated, in relation to the onus of proof, that uncommercial transaction cases could be drawn upon, and that courts may infer a transaction is uncommercial or an unreasonable director-related transaction where the surrounding circumstances, absent some commercial explanation, show a departure from normal commercial practice which raises inferences as to lack of benefit to the company.

His Honour noted that a number of cases had considered the application of voidable transaction provisions, particular ss 120–122 of the Bankruptcy Act 1966 (Cth), where there have been orders for alteration of property interests under the Family Law Act.[9] In *Official Trustee in Bankruptcy v Higgins*, Tamberlin J, citing the earlier cases, said:

> Although the orders were consent orders they were not simply a matter of course or a mere administrative action but they involved the approval of the court: subs79(2). It cannot be said that the Court, in making the orders, was

> engaged in an executive exercise. The Court in making the orders was exercising a judicial discretion in the exercise of federal jurisdiction … as a matter of discretion … it is desirable in this case not to [make an order under s 121 of the Bankruptcy Act] where the Family Court has power to both set aside or vary the order under s79A and to exercise jurisdiction under the [Family Law] Act. Such a course will avoid the appearance of conflicting orders between the two courts.[10]

In *Official Trustee in Bankruptcy v Mateo*,[11] the Full Court of the Federal Court held that a consent order under s 79 of the Family Law Act was not a transfer of property by a person to another person within ss 120–121 of the Bankruptcy Act and so was outside the scope of those provisions.

Moshinsky J accepted that if there was a charge over the property, it was a disposition under s 588FDA(1)(a), and that it may be taken to have been a disposition to the wife and of benefit to the husband as a close associate of the director.

However, his Honour first rejected the allegation that the minutes of proposed consent orders recorded an agreement by the company to create a charge. The main problem here was that D Pty Ltd was not a party to the minutes. It had not signed them and could not be said to be a party in any other way.

Even if D Pty Ltd signed the minutes, his Honour held that they did not show an intention to create a charge *independently and in advance of the making of consent orders by the Family Court.* They showed an intention to propose orders to the court in the terms set out in the minutes. The fact that there were significant differences between the minutes and the eventual orders underlined the point that the court had discretion to make different orders. One key difference was that the court order provided that the husband must pay $500,000 into a trust account in the name of the wife.

While it might be inferred that at some point between the date of the minutes and the making of the consent order 3 days later D Pty Ltd did agree to orders in substantially similar terms, it was not established that the parties reached an agreement which created a charge independently and in advance of those orders.

While a charge was created on the making of the consent orders, no charge was created by agreement of the parties prior to those orders.

The liquidator relied on s 588FDA(3), but his Honour held that subsection is concerned with a situation where a company gives effect to a transaction after it is ordered by the court, such as where the court orders specific performance. Since his Honour had held that D Pty Ltd did not enter into any relevant transaction before the making of the court orders, s 588FDA(3)(b) did not apply.

In any event, as to whether it could be regarded as a transaction that "a reasonable person in the company's circumstances would not have entered into", the evidence did not establish it was of no benefit to D Pty Ltd. The wife had joined the company to her family proceedings and made claims in relation to its property. Her affidavit in those proceedings laid the basis for a contention that declarations should be made that the property was held on constructive trust. It was not possible on the evidence to assess the detriment to the company, as it was providing a secondary level of security (if there was a shortfall). The benefits to other parties are to be taken into account under s 588FDA(1)(c)(iii), and it was not possible to assess the benefits to the husband and wife here.

Lastly, since the liquidator's claim was that the minutes gave rise to an agreement to create a charge, the declarations sought would conflict with the consent orders made by another superior court. It would not be appropriate for that reason to make the declarations, even if his Honour had been satisfied that s 588FDA applied. In that case, she would have been inclined to transfer the proceeding to the Family Court (no application was made to his Honour for such transfer in the course of these proceedings).

Finally, his Honour noted by way of obiter that the liquidator's counsel wanted to reserve the right to argue that the charge arose from the consent orders. However if that was so, then it would not constitute a transaction by the company.[12]

Comment

This case contrasts with the position in the *Kijurina* case discussed in this issue of a binding financial agreement under the Family Law Act. As emphasised in this case, consent orders under the Family Law Act are orders of the Family Court in the exercise of its discretion, not a mere rubber stamp of the minutes of the proposed orders that the parties draw up, especially in this case where the court order differed in significant and relevant ways in relation to the property in question.

While it seems clearly established that consent orders are not transactions or dispositions for the purposes of voidable transactions in personal or corporate insolvency, this does seem to give rise to the possibility of abuse or collusion between husband and wife where insolvency of one of the parties, or of related companies, occurs. Moshinsky J, as earlier judges have done, indicated deference to the Family Court and a preference for transfer of proceedings to the Family Court where property is involved in a dispute under s 79 or other provisions of the Family Law Act, but which might be subject to a clawback argument by a liquidator or trustee in bankruptcy. Section 90AC of the Family Law Act

provides that the Family Court has power to bind third parties despite anything to the contrary in any other Commonwealth law. Presumably the Family Court will not have creditors of a spouse or of a company of which one of the matrimonial parties is an associate uppermost in its mind as parties likely to be affected by any order it makes in disputes between husband and wife or de facto couples. This is in contrast to the position with binding financial agreements as set out in Peter Leech's article in this issue. To that extent, consent orders might seem more impregnable to attacks by insolvency office-holders.

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Footnotes

1. *Kijurina (as Liquidator of ET Family Pty Ltd) v Taouk* (2015) 105 ACSR 686; [2015] FCA 424; BC201503581.
2. *D Pty Ltd (In Liq) v Calas (Trustee)* (2016) FLC ¶93–751; [2016] FCA 1409; BC201611914.
3. *Megalos and Katsaros* [2015] FamCA 1094; BC201551215.
4. R Austin and I Ramsay *Ford, Austin and Ramsay's Principles of Corporations Law* (16th edn) LexisNexis, 2014.
5. *Crowe-Maxwell v Frost* (2016) 91 NSWLR 414; (2016) 335 ALR 518; [2016] NSWCA 46; BC201601612.
6. *Smith v Starke Re Action Paintball Games Pty Ltd (in Liq) (No 2)* (2015) 109 ACSR 145; [2015] FCA 1119; BC201510211.
7. *Weaver v Harburn* (2014) 103 ACSR 416; [2014] WASCA 227; BC201410568.
8. *Vasudevan (as Joint and Several Liquidator of Wulguru Retail Investments Pty Ltd) (in liq) v Becon Constructions (Australia) Pty Ltd* (2014) 41 VR 445; (2014) 97 ACSR 627; [2014] VSCA 14; BC201400731.
9. See *Re Baxter; Ex parte Official Trustee in Bankruptcy and Baxter* (1986) 10 FCR 398; (1986) 10 Fam LR 758; *Re Sabri; Ex parte Sabri v Brien* (1995) 60 FCR 131; (1995) 19 Fam LR 710; BC9506843; *Official Trustee in Bankruptcy v Higgins* (2000) 109 FCR 1; (2000) 183 ALR 459; [2000] FCA 1850; BC200008033; and *Official Trustee in Bankruptcy v Mateo* (2003) 127 FCR 217; (2003) 202 ALR 571; [2003] FCAFC 26; BC200300521.
10. *Official Trustee in Bankruptcy v Higgins*, above n 9, at [21]–[22].
11. *Official Trustee in Bankruptcy v Mateo*, above n 9.
12. *Kalls Enterprises Pty Ltd (in liq) v Baloglow* (2007) 63 ACSR 557; (2007) 25 ACLC 1094; [2007] NSWCA 191; BC200706350.

General Editor's family law and insolvency reading list

Jason Harris *UNIVERSITY OF TECHNOLOGY SYDNEY*

J Campbell and E Young "Stanford, bankruptcy and unsecured liabilities — options and opportunities" (2015) 24(2) *Australian Family Lawyer* 31.

L Sarmas and B Fehlberg "Bankruptcy and the family home: the impact of recent developments" (2016) 40 *Melbourne University Law Review* 288.

J McComish "Three people in the marriage? Testing the limits of pt VIIIAA of the Family Law Act 1975 (Cth)" (2017) 44 *Aust Bar Rev* 186.

G T Riethmuller "The interests of non-spouses in discretionary trusts in family property cases" (2016) 30 *AJFL* 240.

G T Riethmuller "Family law and bankruptcy: an alternative conceptualisation" (2014) 28 *AJFL* 290.

L Sarmas "The resulting trust and the family home in Australia: the end of the road?" (2015) 9 *Journal of Equity* 264.

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