

Recent issues in bankruptcy and family law

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Generally, the *Bankruptcy and Family Law Legislation Amendment Act 2005* ("the 2005 Act") applies to bankruptcies for which the date of bankruptcy was on or after 18 September 2005. The solution was ostensibly simple, but the 2005 Act did not give clear direction to the Courts as to how to resolve disputes between non-bankrupt spouses and trustees. There are now sufficient cases to give clearer, but not definitive, advice as to the range of possible outcomes.

Most de facto couples who separated after 1 March 2009 are now covered by the *Family Law Act 1975* ("FLA") subject to jurisdictional hurdles such as the length of cohabitation and the place of cohabitation. In this paper, the sections of the *FLA* which apply to de facto couples are not stated but, if there are usually equivalent sections in the *FLA*.

Quick overview of property settlements under the *FLA*

Under s 79 (s 90SM for de factos) *FLA* there are four steps to making a property order. In the first step, the Court identifies and values the property of the parties. It does not matter in whose name the property is and whether it was acquired prior to or during the marriage or after separation. The timing of the acquisition may, however, be relevant at the second step. Since December 2002 superannuation has been "treated as property" and the interest of one member can be "split" to give the other party their own interest, either at around the time the order is made or at a later date.

When calculating net property, debts accrued during the marriage are generally considered to be debts of the parties regardless of whose name they are in. There may be a dispute about whether a sum is a debt. For example, advances from family members may be a gift and treated as a contribution on behalf of the donee, or a loan to be repaid.

The main exception to the general rule is for debts incurred through the acts of one party who intentionally or recklessly wasted assets or incurred liabilities, such as gambling debts. This test, which was set out in *Kowaliw and Kowaliw* (1981) FLC 91-092, is high. Baker J said (at p 76,644):

As a statement of general principle, I am firmly of the view that financial losses incurred by parties or either of them in the course of a marriage whether such losses result from a joint or several liability, should be shared by them (although not necessarily equally) except in the following circumstances:

- (a) where one of the parties has embarked upon a course of conduct designed to reduce or minimise the effective value or worth of matrimonial assets, or

- (b) where one of the parties has acted recklessly, negligently or wantonly with matrimonial assets, the overall effect of which has reduced or minimised their value.

Business or taxation debts incurred by one party but where both parties benefited from the enterprise, are generally considered to be joint debts. *The Trustees of the Property of John Daniel Cummins v Cummins* [2006] HCA 6, discussed later in this paper, is an example of a case where the wife benefited from the husband's non-payment of tax. Although it was not decided under the *FLA*, the same conclusion is likely to have been reached under that Act. *Nelson and Perry* [2011] FMCAfam 239 is an example of tax debts which were not considered to be joint debts. The debts were incurred by the husband after separation, the wife knew nothing about them and received no benefit from them, even indirectly, as the husband had paid no child support for the two children who were still under 18.

An ill-considered enterprise is usually undertaken with good intentions. There is a strong argument that the non-bankrupt spouse also has to live with the consequences of the risks associated with the bankrupt's business. Marriage is considered to be a partnership. The Court generally expects that debts incurred by either or both of the parties should be paid from the property of the parties. However, the bankruptcy of one party may affect how the debts are treated. This can be to the trustee's benefit or disadvantage.

Under the second step, contributions to property and the welfare of the family are assessed. Contributions to property by others on behalf of one of the parties are also relevant.

The third step is to look at the nineteen s 75(2) (or s 90SF(3)) factors. They are sometimes called the "needs" factors but this description is too narrow. Relevant matters include incomes, earning capacities, duration of the marriage, care of children, standard of living, and the financial circumstances of new partners. Usually, bankrupts (and therefore trustees) do poorly under this step. Unless the bankrupt is able to gain or retain sufficient property from the property settlement to discharge all the debts and the expenses of the trustee, any funds received by the bankrupt under the property order will go to the trustee and not be directed towards the bankrupt's needs. The trustee does not have future needs which can be met from a s 79 (s 90SM) order in the same way as an individual does. This step has, in the past, favoured a non-bankrupt spouse. However, s 75(2)(ha) (s 90SF(3)(i)) specifically provides that the court 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." This is discussed further below.

The fourth step is to check that the orders proposed are just and equitable under s 79(2) (s 90SM(3)).

There is considerable judicial discretion at all these steps. Usually, lawyers will give clients a range of outcomes, say 50 to 60% or 60 to 70%. Since the 2005 amendments, the range of possible outcomes is even greater in cases involving a bankrupt because of uncertainty about the size of the net pool. The range for the non-bankrupt spouse or the trustee may be between nil and 100%.

Unsecured debts

The Family Court has historically given priority to unsecured creditors without judgment debts over the claims of non-bankrupt spouses. Their claims have not been proven in a court, yet the debts are often treated by the parties and the Court as if they have been.

In *Biltoft and Biltoft* (1995) FLC 92-614 the Full Court looked at the position of unsecured creditors saying (at p 82,124):

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. In the case of encumbered assets, the value thereof is ascertained by deducting the amount of the secured liability from the gross value of the asset... Gibbs J. (as he then was) pointed out at p 355 [in *Ascot Investments*] that the Court “must take the property of a party to the marriage as it finds it. The Family Court cannot ignore the interests of third parties in the property, nor the existence of conditions or covenants that limit the rights of the party who owns it”. Where the assets are not encumbered and moneys are owed by the parties or one of them to unsecured creditors, the Court ascertains the value of their property by deducting from the value of their assets the value of their total liabilities, including the unsecured liabilities...

The Full Court then said (at p 87,127):

Notwithstanding the general practice which has developed, the Court has indicated that it may properly determine not to take into account or to discount the value of an unsecured liability in certain circumstances. Such liabilities would include but are not limited to a liability which is vague or uncertain, if it is unlikely to be enforced or if it was unreasonably incurred.

The Full Court concluded in relation to the general rule (at p 82,128-9):

The rule is not absolute, is not prescribed by the statute and there are a number of well recognised exceptions.... There is no requirement that the rights of an unsecured creditor or a claim by a third party must be considered and dealt with prior to the Court making an order under s 79, nor is there a rule of priority as between a creditor

claimant and a spouse. Those rights, however, cannot be ignored. They must be recognised, taken into account and balanced against the rights of the spouse.... There is an obligation on both parties to disclose any significant creditors or any significant claim against either of them by a third party. If, as a result of the order of the Court in the property proceedings, the ability of a creditor or claimant to recover his or her debt or claim is likely to be affected, notice of the Family Court proceedings must be given to that creditor or claimant. He/she may then intervene in the Family Court proceedings and either seek a stay of those proceedings or some appropriate order which recognises his/her rights.

A creditor may seek to intervene but there is doubt as to the ability of the Family Court or the Federal Magistrates Court to determine a disputed debt if it is only exercising *FLA* jurisdiction, despite the introduction of Pt VIII A A (Orders and Injunctions Binding Third Parties).

The Full Court of the Family Court in *Puddy and Grossvard* (2010) FLC 93-432 was clear that both s 79(10)(a) and s 75(2)(ha) refer to debts which are uncontroversial. Coleman J said (at para 61):

However, I am not convinced that the combination of these sections provides a jurisdictional basis for entertaining the liquidator's claim. These provisions enable a creditor to intervene in proceedings in the circumstances referred to in s 79(10)(a), and oblige the court in such circumstances to have regard to the matter identified in s 75(2)(ha). There is a material distinction between being a "creditor" and asserting an indebtedness which is disputed. A jurisdictional basis other than s 79 thus needs to be enlivened in order for the court to entertain disputed debt claims.

Warnick and Boland JJ said at (paras 102-3):

We agree with Coleman J that there is power within the terms of the *Family Law Act 1975* (Cth) ("the 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, we doubt that, leaving aside the accrued jurisdiction, there is power to bind a creditor, even if 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.

In short, in our view, the principles enunciated in *Biltoft and Biltoft* (1995) FLC 92-614 and 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, not to the proof of those debts, against one or other or both of the parties to the marriage, where liability is in issue.

The liquidator relied on accrued jurisdiction. It raised, but did not pursue using Pt VIII A A as a possible source of jurisdiction.

In the past, the Family Court was particularly concerned to ensure that revenue authorities such as the Australian Taxation Office and State Revenue Offices were paid (eg. *Chemaisse and Chemaisse* (1988) FLC 91-915). Priority was often given to tax debts over the non-

bankrupt spouse and other unsecured creditors (*Hannah and Hannah; Tozer and Tozer* (1989) FLC 92-052). However, Coleman J in *Lemnos and Lemnos* (2009) FLC 93-394 considered that the Australian Taxation Office no longer had priority over other creditors due to the *Insolvency (Tax Priorities) Legislation Amendment Act 1993*. Among other amendments, s 123(5) was deleted. This section protected payments of tax. The trial Judge, Le Poer Trench J, for different reasons, agreed. He said (cited at para 127 of the Full Court's judgment):

I have some concern with the outcome of this case insofar as the creditor principally to lose out in this case is the Australian Tax Office and therefore the tax payers of this land. The question should realistically be asked why the wife should ultimately prosper at the expense of the public purse. The answer so far as I am concerned is that the *Family Law Act* as now standing provides for that to be the outcome in appropriate cases. The legislation does not elevate the status of creditors to a ranking above the other considerations.

Section 75(2)(ha) FLA

The factors to be considered in property and spousal maintenance cases under s 75(2) and later (s 90SF(3)) *FLA* were changed by the 2005 Act. Section 75(2)(ha) *FLA* was added, requiring 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 practice, this means that in the four-step process under s 79 *FLA*, after considering the contributions made by each of the parties to the marriage, the interests of creditors are one factor amongst many to be considered under s 75(2). The interests of creditors are not given more or less weight than other factors.

In *Lasic and Lasic* [2007] FamCA 1188 the husband's trustee in bankruptcy sought to set aside consent orders made between the husband and the wife. Under the orders the husband's interests in 6 jointly owned pieces of real estate were transferred to the wife. The wife conceded that the inference was open that the consent orders had been entered into to avoid the payment of a possible damages award against the husband, such that the making of the orders was a miscarriage of justice. The trial Judge required the wife to pay \$319,081 to Mr M, a creditor, who had sustained serious injuries as a result of being shot due to the negligence of the husband and the parties' son.

On appeal, in *Trustee for the bankrupt estate of Lasic and Lasic* (2009) FLC 93-402, the Full Court understood the trial Judge's concern that if the husband's entitlement was paid to the

trustee, Mr M would receive nothing. Reluctantly, the Full Court concluded that ordering a direct payment by the wife to Mr M was not within the trial Judge's power.

In *Orchard and Orchard* [2008] FamCA 979, Dessau J acceded to the submissions by the husband's trustee about s 75(2)(ha) that she should consider it relevant that the husband's superannuation was exempt under s 116(2)(d)(iii) *Bankruptcy Act 1966* ("BA"). The trustee wanted the wife to receive a superannuation split and Dessau J ordered one. She said (at paras 93-4):

The effect of the order is that the wife shall not receive further assets immediately. She has received some, but I am conscious that the balance of her share of the settlement will be in superannuation that she cannot yet access (she is 48 years old). However, she is housed and financially secure with Mr W. She moves into the future secure, and this gives her own financial resource.

The effect of the order is the opportunity for the husband's creditors to be satisfied, as he shall retain the non-exempt asset.

The Full Court in [2009] FamCAFC 90 dismissed the wife's appeal.

In *Malta and Malta (No 3)* [2008] FamCA 748 Cronin J refused to take superannuation only into account as a s 75(2) factor as the parties submitted. The wife's petitioning creditor was a party to the proceedings as the bankruptcy petition had been transferred to the Family Court. Cronin J discussed s 75(2)(ha) and refused to make an adjustment under s 75(2), saying (at paras 112 and 117):

I have contemplated the problem set out in s 75(2) (ha) relating to the orders I make in relation to creditors. In relation to the wife, it would clearly seem that there is nowhere near enough in the entitlement of the wife to enable her to satisfy all of her creditors. On the other hand, I have been told that the husband has a debt to the Australian Taxation Office of something in the vicinity of \$2 million and there is no prospect that he will be able to pay that. Whether anybody bothers to enforce that debt is a matter beyond my control...

One of the difficult issues in this case having regard to the bankruptcy jurisdiction that I am being asked to exercise is the fact that any order I make in favour of the wife may very well end up in the hands of a very few people particularly having regard to the costs of the petitioning creditor. As such, to make an adjustment of a modest sum in favour of the wife in this case would have little, if any, value for the wife. Her sum on all of the evidence I have seen, will end up in the hands of the creditors. Even so, there is little between the parties of difference when I balance up all of those factors. In my view, there is no basis for an adjustment under s 75(2) of the Act in this case.

In *Pippos and Pippos* [2008] FamCA 542, debts incurred by the husband post-separation led to the husband's bankruptcy. Burr J gave the wife 5% on account of s 75(2) factors. He said he would have given her 10% but the factors in her favour were partially balanced by those

which favoured the trustee in bankruptcy under s 75(2) (ha) and (n) and the regard he must have to the husband's creditors' ability to recover their debts. He did not seem to consider it relevant that the debts were incurred post-separation.

In *West & West* [2007] FMCA fam 681 without the husband giving evidence there was no evidence of any contributions by him to the purchase of the former matrimonial home. The court was satisfied that the wife had made the majority of the contributions to the party's property and that the property (including superannuation) ought be divided 85%/15% in favour of the wife. In relation to s 75(2) factors the trustee was also hampered by the absence of evidence on behalf of the husband.

The Federal Magistrate considered it relevant under s 75(2) (ha) that creditors were unlikely to receive a dividend from any monies which the court ordered the trustees be entitled to receive out of the matrimonial property. He agreed with the submissions on behalf of the wife and said (at para 111):

It would be *perverse* if the wife and children were "*forced from their home*" and the operation of those relevant provisions of that legislation in relation to "*the Trustees' costs*" meant RACV Finance would remain out of pocket.

In *Commissioner of Taxation and Worsnop* (2009) FLC 93-392 the Commissioner of Taxation appealed against an order that the former matrimonial home be sold and, after the costs of sale, the proceeds be divided equally between the wife and the Commissioner. The only substantial asset was the home worth \$4.75 million. There was conflicting evidence as to the wife's knowledge of the husband's tax avoidance but the trial Judge accepted that the wife did not know. The trial Judge made no adjustment in favour of the wife for s 75(2) factors although she had the primary care of 4 children aged between 1¾ and 13 years and this affected her earning capacity. Her s 75(2) factors were off-set against the husband's indebtedness to the ATO as a factor in the Commissioner's favour under s 75(2)(ha).

In balancing the competing claims of the wife against the Commissioner, the Full Court found that the trial Judge clearly appreciated the critical features of the exercise, and said (at para 86):

In our view, the Commissioner of Taxation is in a position distinguishable from that of a commercial creditor. Commercial creditors have a choice about to whom they extend credit. On the other hand, the position of the Commissioner as a creditor of taxpayers is of a completely different origin. The onus is on taxpayers to make full and proper disclosure to the Commissioner of Taxation. The Commissioner does not extend credit at all, but becomes a creditor by virtue of the conduct of the affairs of the taxpayer. As seen, Rose J gave "...much weight to the fact that the outstanding tax indebtedness of the husband is a debt to the Crown and implicitly there is a public

interest issue”, though he also recognised that the Commissioner had no priority over the wife’s claims.

A case in which the trustee improved its position was *Reua and Reua* [2008] FamCA 1038. Before the trial commenced, the trustee and the wife each held property of about \$320,000. There was no debate about the secured creditors. The husband's unsecured creditors were owed \$233,860 and contingent unsecured creditors claimed about \$850,000. The wife sought to retain all the assets vested in the trustee. The husband sought an equal division of non-vested property between himself and the wife and that the trustee pay unsecured creditors from the trustee's share. The trustee sought that the wife and the trustee each retain the property they currently owned. Stevenson J said (at paras 69, 96-7:

Principally, these liabilities are thus pre-separation debts or amounts spent on the construction of various properties. I see no reason to exclude any of these unsecured debts in the calculation of the value of the net pool of property...

The orders sought by the wife would mean that no unsecured creditor could recover its debt. She sought to retain the property which she holds and to take all of the property vested in the Trustee. There would thus be no funds available to the Trustee from which he could pay any of the creditors.

The orders sought by the husband would mean that the unsecured creditors would be paid. The orders sought by the Trustee would permit him to discharge the debts to the unsecured creditors, from the property presented vested in him.

Stevenson J ordered a 65%/35% split of the vested and non-vested property so that the wife paid the trustee the sum of \$118,892.

The Fourth Step

The fourth step in the property settlement process is to assess the justice and equity of orders under s 79 FLA (eg. *Hickey and Hickey and the Attorney-General for the Commonwealth of Australia (Intervener)* (2003) FLC 93-143). In practice, this involves stepping back to look at the outcome of the previous steps. Usually this means:

- What are the dollar amounts (rather than percentages) each party will receive?
- Has there been a superannuation split and if not, should there be one and how much?

Burr J said in *Pippos and Pippos* [2008] FamCA 542 (at para 62):

Whilst it is necessary in the journey towards a result in property settlement proceedings between the wife and the trustee to consider relevant matters which emerged from the marriage relationship, the rights of the husband’s creditors and considerations which must apply to the husband’s creditors represented by the trustee

mean that ultimately the orders I make on the issue of property settlement are as between the wife and the trustee and hence it is to them that the justice and equity of my orders must apply.

In *Pippos and Pippos* the husband retained his superannuation benefits of \$17,000 which could not be accessed by the trustee as part of his 30% of the pool. The balance due by the wife to the trustee under the orders was \$39,741. That was \$20,000 more than the wife indicated that she had the capacity to borrow. Burr J was satisfied that it represented a just and equitable outcome in the circumstances. The orders recognised the wife's significant contributions during the marriage, the s 75(2) factors which favoured her position overall and the entitlement of creditors to recover a proportion of their debts. After deduction of the trustee's costs of \$31,500, the creditors were likely to recover \$8,241 of the total due to them of \$28,577, or a return of about 29 cents in the dollar.

Setting aside orders and transactions under the *FLA*

In the past, a trustee could, in certain circumstances, challenge orders under s 79A if the orders defeated their interests. A trustee could argue that there had been a miscarriage of justice by reason of fraud, duress, suppression of evidence (including the failure to disclose relevant information), the giving of false evidence or any other circumstance (s 79A(1)(a)).

The ability of creditors and the trustee to use s 79A was considered in such cases as *Semmens v Commonwealth of Australia & Collector of Customs* (1990) FLC 92-116 and the *Official Trustee in Bankruptcy v Donovan* (1996) FLC 92-703. A creditor's standing to apply to set orders aside under s 79A was further clarified by the 2005 Act. Section 79A(4) provides that a creditor of a party is taken to be a person whose interests are affected by the order if the creditor may not be able to recover their debts because the orders was made.

The trustee's standing to apply under s 79A was made absolutely clear by the amendment of s 79A(5) in 2005. A trustee is taken to be a person whose interests are affected by a s 79 order if, when the order was made, one of the parties to the marriage was a bankrupt or a party became bankrupt after the order was made.

Since 2005, a transaction made to defeat a claim is able to be set aside on more grounds. If the trustee is a party to proceedings under the *FLA*, the Court may set aside or restrain the making of an instrument or disposition:

- which is made or proposed to be made by or on behalf of, or by direction or in the interests of, the bankrupt; and

- which is made or proposed to be made to defeat an existing or anticipated order in those proceedings or which, irrespective of intention, is likely to defeat any such order (s 106B(1A) *FLA*).

Section 106B(1) can also be used by a trustee in bankruptcy. In practice, s 106B orders are made more readily than orders under the *BA* clawback provisions (s 120-122).

An injunction can be granted on the application of the non-bankrupt spouse, restraining the trustee in bankruptcy from declaring and distributing dividends among the bankrupt's creditors (s 114(4) *FLA*).

Financial agreements

Financial agreements may not be as secure for the parties as consent orders if bankruptcy is a possibility. Consent orders have the approval of the Court and, provided there has been full disclosure of the debts and notice to third party creditors, they may be more difficult to set aside than a financial agreement entered into by the parties in private.

Following *ASIC v Rich* (2003) FLC 93-171, amendments were made to the *FLA* and the *BA* to protect the position of the trustee in bankruptcy and creditors with respect to a financial agreement. These amendments included:

- creditors have standing to apply to set a financial agreement aside (s 90K (1A))
- it is an act of bankruptcy if a person becomes insolvent as a result of a transfer or transfers made under a financial agreement (s 40(1)(o) and s 40(7) *BA*)
- the claw back provisions in the *BA* can be used to recover property transferred under a financial agreement (s 40(1)(o) and s 120 *BA*)
- a separation declaration must be made before a financial agreement comes into force or takes effect if it relates to property or financial resources (s 90DA(1) *FLA*)

Transfers pursuant to court orders are protected by s 59A *BA*. Property transfers pursuant to a financial agreement can be clawed back under s 120(1) *BA* if the transfer was within the previous 5 years and the transferee gave less than market value for the property transferred.

The position before 2005

Before the 2005 Act changes, a non-bankrupt spouse could not make a claim under s 79 *FLA* against property which had vested in the trustee under s 58 *BA*. Various courts struggled to resolve disputes between a non-bankrupt spouse and a trustee in bankruptcy about a bankrupt's property.

Although often supportive of the interests of trustees and creditors, the Federal Court at times tried to protect the interests of the non-bankrupt spouse by recognising the value of non-financial contributions. The Full Court of the Federal Court took this approach in *Official Trustee in Bankruptcy v Mateo* (2003) FLC 93-128 and *Official Trustee in Bankruptcy v Lopatinsky* (2003) FLC 93-149; relying on equitable principles. In *Mateo*, homemaking and parenting contributions were relevant when determining whether the consideration for a transfer was at market value. In *Lopatinsky*, wife's homemaking and parenting contributions under s 79 could not be used to establish her interest as the beneficiary of a trust. Her interest had to be assessed on equitable principles.

The rights of non-bankrupt spouses as against the trustee in bankruptcy were developed in the High Court case of *The Trustees of the Property of John Daniel Cummins v Cummins* [2006] HCA 6. The trustee did much better than might previously have been expected. This decision dealt with the law prior to the 2005 Act, but the principles appear to be unchanged.

***Cummins* and equitable principles**

In *Cummins*, the bankrupt and his wife purchased vacant land as joint tenants in 1970. The bankrupt paid one-quarter of the purchase price and his wife paid the balance. They built a house on the land using joint funds and jointly borrowed funds. In 1987 the bankrupt transferred his half interest in the home to the wife. She paid stamp duty on the transfer but did not pay the monetary consideration stated on the transfer. The bankrupt was a barrister who did not lodge tax returns for about 40 years. His tax liability in 2000 was almost \$1,000,000. He became bankrupt in December 2000. The trustee in bankruptcy was successful before a single Judge of the Federal Court, unsuccessful before the Full Court of the Federal Court and successful in the High Court.

The High Court found that in a traditional marriage it is often “a purely accidental circumstance” whether money is contributed by a party to the purchase of the home or to living expenses. It concluded that in 1987 the wife’s beneficial interest in the home did not

exceed her legal interest before the transfer. After the legal transfer, her beneficial interest remained at 50%. The trustee was, therefore, entitled to 50% of the equity in the home.

Cummins is arguably the most useful recent development for trustees in bankruptcy and its impact has not been watered down by the 2005 Act. However, constructive trust and other equitable principles remain relevant.

In *Official Trustee in Bankruptcy and Brown* [2011] FMCA 88 the property was registered in the sole name of the non-bankrupt spouse. The trustee relied on *Cummins*. Driver FM accepted that the case had to be decided with due regard to the dicta in *Cummins*, in particular (at para 71) where the High Court quoted from Professor Scott's *The Law of Trusts*, 4th ed (1989), vol 5, §454 at 239:

Where a husband and wife purchase a matrimonial home, each contributing to the purchase price and title is taken in the name of one of them, it may be inferred that it was intended that each of the spouses should have a one-half interest in the property regardless of the amounts contributed by them

However, Driver FM distinguished the case before him, saying (at para 30):

I have no difficulty in accepting that Ms Brown did not hold the property solely for herself but also held it on trust for Mr Daevys in recognition of the contribution he made to its acquisition, maintenance and improvement. It is certainly open to me to find, as the Official Trustee contends I should that the property was held jointly by Ms Brown and Mr Daevys. However, I do not accept that this case must be determined in conformity with the High Court decision of *Cummins v Cummins*. First, this case can be distinguished from *Cummins* on the basis that the purchase of the Property by Ms Brown occurred prior to the marriage and without any apparent intention to assist Mr Daevys to defeat his creditors. It was no doubt convenient for Mr Daevys to conceal his interest in the Property from the Official Trustee until after his discharge from bankruptcy, in the mistaken belief that he could thereby withhold that asset from his creditors. That, however, was Mr Daevys' scheme, not Ms Brown's.

The Court treated the contributions by the parties to the Property not under the *FLA* but as a joint venture relying on such cases as *Baumgartner v Baumgartner* (1987) 164 CLR 137, *Muschinski v Dodds* (1985) 160 CLR 583 and, particularly the mathematical approach taken in *Calverley v Green* (1984) 155 CLR 242. The Court ordered that the wife receive 67% of the net proceeds of sale and that the Official Trustee receive the balance. The Trustee had sought a 50%/50% division.

Recent cases have considered equitable principles. In *Holden v Santosa* [2011] FMCA 251 the non-bankrupt spouse unsuccessfully argued, *inter alia*, that there was a constructive trust. In *Official Trustee in Bankruptcy v Draper* [2006] FCAFC 157 the matter was remitted to the Federal Magistrates Court for rehearing and an equitable accounting and in *Sui Mei Huen v* {000154/152876-5 }

Official Receiver for Official Trustee in Bankruptcy [2008] FCAFC 117 a declaration was made that the trustee's half interest was held on constructive trust for the non-bankrupt spouse. In *Sui Mei Huen* the Full Court of the Federal Court said (at para 78):

Whether a constructive trust exists is assessed by circumstances existing at the time when the property is acquired though events after its acquisition are not irrelevant ... and its existence does not depend upon the intention of the parties

The 2005 Amendments

The 2005 Act gave the Family Court power to make s 79 *FLA* orders about property which has vested in a trustee in bankruptcy. The court can order that property, otherwise available for distribution to creditors, be transferred to the non-bankrupt spouse.

The general rule under the *BA* that property vests in the trustee at the date of bankruptcy (s 58 *BA*) is subject to property settlement and spousal maintenance orders (s 59A *BA*). A new form of exempt property was added by the 2005 Act. Section 116(2)(q) *BA* provides that property of the bankrupt is exempt if, under a Pt VIII *FLA* order, the trustee is required to transfer that property to the spouse of the bankrupt. Section 116(2)(r) refers to orders under Pt VIIIAB.

Since the 2005 Act, at the third step of the four step s 79 process, the interests of creditors are considered as one of the factors under s 75(2) (s 75(2)(ha)).

The definition of "matrimonial cause" was extended, but not far enough to cover the position in *McCormack and McCormack* and *Peakes and Peakes* [2009] FMCAfam 1250 where two wives and their husbands' trustees in bankruptcy tried to obtain court orders for the transfer of half interests of properties to the wives from their husbands' trustees in bankruptcy. The aim was apparently to avoid stamp duty. The wives were not separated from their husbands and the court refused to make the orders sought.

The effect of the 2005 Act was considered by the Full Court in *Trustee of the Property of G Lemnos and Lemnos* (2009) FLC 93-394. The trustee of the husband's bankrupt estate successfully appealed against property orders which required that the former matrimonial home, which had vested in the trustee, be sold and the net proceeds divided equally between the trustee and the wife.

The trial Judge found that the wife had contributed directly to the matrimonial home through her income (from distributions received by her from the family trust which received income

from the husband's legal practice) and a guarantee. Contributions were assessed as equal at the date of the trial.

The husband was re-assessed for income tax for the period 1991- 2002. A sequestration order was made against him in 2006 but he was allowed to continue working as a solicitor. The parties separated in July 2007. At the time of the trial the equity in the home was about \$2-2.5 million and the husband's bankrupt estate had debts of about \$6 million.

The Full Court held that the interests of unsecured creditors did not automatically prevail over the interests of the non-bankrupt spouse and the Court must balance their competing claims in the exercise of the wide discretion conferred by s 79.

The wife argued that the husband wasted assets by acting recklessly and negligently in completing his tax returns, an act wholly within his knowledge. For twelve years he claimed outgoings on a property which was usually his primary residence. The majority found that the husband's conduct was not within the exceptions to the *Kowaliw* principle, as it was not designed to *diminish* the value of the matrimonial assets, but to *increase* them. The wife received the benefit of the funds which flowed from the husband's conduct, and it was neither just nor equitable for her to escape all responsibility for payment of the *primary* tax.

The majority followed the Full Court in *Johnson and Johnson* [1999] FamCA 369 which said "unless there were compelling circumstances to the contrary, a just outcome demanded that the wife take the good with the bad" and that unless "the husband was on a frolic of his own and acting contrary to the wife's express wishes" there was no reason for the trial Judge to leave the husband with the burden of the tax penalties.

The majority in *Lemnos*, unlike in *Johnson*, accepted that the husband was "on a frolic of his own" but did not accept that the wife's lack of knowledge or complicity in the husband's wrongful deductions determined whether she should share responsibility for the payment of *primary* taxation on his income during the marriage. The statement in *Johnson*, that spouses should generally "take the good with the bad," had even more force when applied to allocating responsibility for *primary* taxation, rather than tax penalties.

Coleman J observed that, having ordered that the wife should receive 50% of the equity in the home, the trial Judge gave priority to the wife over the unsecured creditors. The unsecured creditors, owed approximately \$6 million, received the same dollar amount as the wife, or about 17.5-21.6% of their claims. Coleman J concluded that the trial Judge's discretion

miscarried. By finding that the husband should satisfy the ATO debt from his resources, he had already decided the issue which s 75(2)(ha) directed him to consider.

In *Lemnos* (2009) FLC 93-394, took a more favourable approach to the position of the trustee in bankruptcy than taken by the trial Judge. Thackray and Ryan JJ allowed the appeal because of the trial Judge's treatment of the primary tax burden as "waste." Coleman J allowed the appeal because of the way the trial Judge applied s 75(2)(ha). In the later case of *Trustee of the property of G Lemnos, a bankrupt & Lemnos and Anor (No. 2)* [2009] FamCAFC 200, the Full Court remitted the matter for re-trial.

In *Rand and Rand (No 2)* [2009] FamCAFC 155 the husband appealed against an order entitling the wife to half of the profits arising out of patents or intellectual property relating to the conversion of waste material to building products and that the husband account to the wife and pay to the wife half of any profits received in respect of intellectual property of various companies and related entities. This entitlement to profits was limited to the extent of the wife's unsatisfied property entitlements, costs and interest.

The majority considered the husband's standing to appeal. The trial, which involved the husband, the wife, the husband's trustee in bankruptcy and eleven other third party respondents took place over 24 days between September 2007 and November 2007. By the time judgment was delivered, the husband was a discharged bankrupt.

The Full Court distinguished *Cummings v Claremont Petroleum NL and Anor; Fuller v Claremont Petroleum NL and Anor* (1995 - 1996) 185 CLR 124, *Giurgis v Giurgis Official Trustee in Bankruptcy* (1997) FLC 92-726 and *O'Neill v O'Neill* (1998) FLC 92-811. In relation to *Cummings*, the majority said (at para 41):

The bankrupts personally stood neither to gain nor lose by being permitted to appeal. Their trustees had not appealed the decision on their behalf. On the facts of the case, it would have been surprising, and potentially an abuse of the court's process to grant the bankrupts standing to appeal.

The bankrupt in *Rand* had an "interest" which the bankrupts in the other cases lacked. The majority, Coleman and Crisford JJ distinguished *O'Neill* and said (at paras 49, 51):

The pivotal issue in the current appeal did not arise in any of the authorities to which we have referred. There was no issue in any of those cases that the fruits of a successful appeal would be received by the bankrupt's trustee or, to the extent that there might be a surplus, by the bankrupt to the extent of such surplus. The sole issue for determination in the present appeal is whether the order under challenge imposes obligations upon the husband personally or upon property vested in his former trustee

in bankruptcy. The potential “interest” of the bankrupt is thus significantly dissimilar to that revealed in each of the authorities to which we have referred.

We are not persuaded that the husband lacks standing to prosecute his appeal. The outcome of this appeal may have significant implications for the husband in his pending appeal against orders made against him as a consequence of findings that he breached the order which gives rise to the present appeal. In those circumstances, we are persuaded that the husband has an “interest” sufficient to provide standing to challenge the trial Judge’s order.

The majority concluded (at para 112):

Although a less than satisfactory state of affairs, the effect of the matters to which we have referred is that it falls to the husband’s former trustee in bankruptcy, by disclaiming or continuing not to disclaim the technology, to effectively determine the extent to which orders apparently directed to the husband personally actually impose personal obligations upon him. Regrettably, in the absence of any appearance by or on behalf of the husband’s former trustee in bankruptcy in this Court, we cannot take that matter further. However, nothing to which we have been referred, or discovered for ourselves, persuades us that the trial Judge’s orders would defeat attempts by the wife to enforce them against the husband’s former trustee in bankruptcy if he does not disclaim the technology, or against the husband if he does. How successful any such attempts may prove is another question altogether, and not one requiring determination in this appeal.

Warnick J dismissed the appeal for different reasons.

What approach to take to debts?

Federal Magistrate Walters, in his paper "Some Aspects of the Interaction of Bankruptcy with Family Law" (12th National Family Law Conference, Perth 2006) set out principles, considerations or factors likely to be relevant to the balancing exercise between the interests of the parties to the marriage and those of the creditors of a bankrupt spouse. He suggested that, where applicable, they should form the subject of appropriate evidence:

- (a) Any order that the Court might be minded to make which is likely to impact upon a creditor in the sense of affecting the creditor's rights must be "reasonably necessary, or reasonably appropriate and adapted ..." to effect a just and equitable division of property between the parties to the marriage and must take into account the legitimate interests of that creditor (see *FLA* s 90AE(3) and (4));
- (b) The Court might be minded to consider, including in the context of (for example) an "add back", or in the context of deciding whether or not to "ignore" a debt:
 - (i) whether one of the parties "... has embarked upon a course of conduct designed to reduce or minimise the effective value or worth of 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". (see *Kowaliw*);

- (ii) The non-bankrupt spouse's knowledge of the events leading to the other spouse's bankruptcy, including (for example) the nature and degree of the non-bankrupt spouse's involvement in the business or investment activities of the bankrupt spouse, and whether, and to what extent, the non-bankrupt spouse "... has either benefited from, or contributed to, the bankrupt spouse's insolvency"; (CCH *Australian Family Law & Practice*, para 40-740);
- (iii) When and how a relevant debt was incurred by the bankrupt spouse, and whether, for example, the debt was incurred "in deliberate or reckless disregard of (the non-bankrupt spouse's) potential entitlement under s 79". *Biltoft, Kowaliw and ASIC v Rich*);
- (iv) The factual circumstances surrounding the commencement or continuation of the property settlement proceedings – including, for example:
 - whether the parties' marriage has broken down and/or the parties have separated; and/or;
 - whether property settlement proceedings are or appear to be a strategic or tactical plan or initiative designed, in some way, to insulate the assets of the family (or a member of the family) from creditors, or to otherwise prevent creditors (or the Trustee on their behalf) from recovering their debts, or an appropriate part thereof.
- (v) Whether a creditor knew or ought to have known of a claim or potential claim by the non-bankrupt spouse to the bankrupt spouse's property prior to or at the time that the debt was incurred;
- (vi) Whether and in what manner the creditor pressed or pursued – directly or indirectly – his/her rights in relation to the payment of the debt prior to bankruptcy, or prior to the commencement of proceedings in the relevant Family Law Court, and whether the creditor did so in a timely fashion;
- (vii) Whether, by words or conduct, a creditor (or Trustee) led or permitted the non-bankrupt spouse to form a reasonable view that the debt would not be pressed, pursued or enforced, and whether (and in what way) the non-bankrupt spouse was thereby induced – whilst acting in good faith – to change his/her financial position;
- (viii) Whether, by words or conduct, the non-bankrupt spouse led or permitted the creditor (or Trustee) to form a reasonable view that the non-bankrupt spouse's actual or potential entitlements under the *FLA* would or might not be pressed, pursued or enforced, and whether (and in what way) the creditor (or Trustee) was thereby induced – whilst acting in good faith – to change his/her financial position.
- (ix) Whether either of the spouses has failed to make a full and frank disclosure of his/her financial position at all relevant time;
- (x) Whether the Trustee has failed to make a full and frank disclosure of all relevant information as it relates to the identification and valuation of the property comprising the vested bankruptcy property, and a full and frank disclosure of all relevant information relating to provable debts;

- (xi) The overall financial circumstances of the non-bankrupt spouse and the children of the parties during the period since the incurring of the relevant debt or debts, and at the time of the property settlement proceedings (including the effect on the non-bankrupt spouse and the parties' children of the orders proposed by the parties to the proceedings).

These seem to be a sensible starting point for the parties to address in the absence of more specific Full Court guidance. Other factors which might be relevant are:

- Whether the debts were incurred pre- or post-separation
- Whether the debts were incurred directly or indirectly for the benefit of both parties

Right to commence proceedings

The non-bankrupt spouse can bring s 79 proceedings, as can the bankrupt. It appears that the 2005 Act did not give the trustee the right to institute proceedings under the *FLA*. The Full Court in *Doisy v Wilmont-Doisy* [2009] FamCAFC 14 confirmed that there is jurisdiction for the court to make a declaration under s 78 *FLA* in favour of a third party, in this case the husband's second wife. Section 78 states:

- (1) In proceedings between the parties to a marriage with respect to existing title or rights in respect of property, the court may declare the title or rights, if any, that a party has in respect of the property.
- (2) Where a court makes a declaration under subsection (1), it may make consequential orders to give effect to the declaration, including orders as to sale or partition and interim or permanent orders as to possession.

The trustee may, if proceedings have already been instituted, be able to make a claim under the *FLA* to claw back property or seek that the Court exercise jurisdiction outside its usual jurisdiction on a cross-vested or accrued basis.

Section 79 gives a right *in personam* and does not vest in the trustee (*Page and Page* (No 2) (1982) FLC 91-241; *Reed and Reed*; *Grellman (Intervener)* (1990) FLC 92-105; *Audet v Audet*; *Official Trustee in Bankruptcy (Intervener)* (1995) FLC 92-607). However, if the bankrupt receives any property under a s 79 order, that property will vest in the trustee as after-acquired property (s 58(1) (b) *BA*), subject to the exempt property provisions. A superannuation split is, for example, exempt under s 116(2) (d) (iva) *BA*.

Joinder of trustee to *FLA* proceedings

The trustee in bankruptcy is not automatically a party to property settlement proceedings. Since the 2005 Act it is, however, easier to show that a trustee has an interest in the proceedings. For example, a trustee must be joined as a party, if the trustee applies to be joined, and if:

- either when the application was made, the party was a bankrupt or after the application was made but before it is finally determined, the party becomes a bankrupt; and
- the Court is satisfied that the interests of the bankrupt's creditors may be affected by the making of a property settlement order (s 79(11) *FLA*)

The procedure for any third party to become a party to a case is either by being named as a respondent by one of the parties to the case, or by applying to intervene in a case. The first option is the simplest, if the third party consents to being joined.

A party to a case may add another person as a party. This is done by either:

- naming the person as a respondent in the application (r 6.03(1))
- after the case has started by amending the application to add the name of the person (r 6.03(2))

The procedure for adding a person is to:

- (a) file an affidavit setting out the facts relied on to support the application, including a statement of the new party's relationship (if any) to the other parties; and
- (b) serve on the new party:
 - (i) a copy of the application, amended application, response or amended response; and
 - (ii) the affidavit mentioned in paragraph (a); and
 - (iii) any other relevant document filed in the case (r 6.03(3)).

Cronin J in *Pencious and Pencious* [2010] FamCA 605 took issue with the apparent simplicity of r 6.03. He said (at paras 1, 2, 4):

...In my view it is not that simple.

The recipient of the application for joinder as well as all other parties to the litigation must be able to identify what material facts give rise to a cause of action against the party sought to be joined. Perhaps the practical test is whether the application would enable the party so joined or to be joined, to respond, in the sense of filing a defence to the claim.

After pointing to the jurisdictional basis upon which orders are sought (if they are), the application for joinder (or the person seeking to defend having joined a person) must be able to show that the rights of those persons may be affected by an issue in the case but also that participation is necessary to enable the court to determine all issues in the case.

He agreed with the Full Court in *B Pty Ltd and Ors and K* (2008) FLC 93-380 which said (at paras 43-44):

In the usual run of applications for alteration of property interests or parenting orders, the fact of marriage or parenthood, accompanied, in respect of the former, by a history of contribution to and acquisition of, property and, in respect of the latter, evidence that relates to any aspect of a child's interests, is sufficient to make the existence of a "cause of action" apparent. No pleading in the traditional sense is required to identify further facts material to the cause.

However, the narrative or descriptive nature of evidence is often unsuited to formulate or particularise a cause of action against a third party. Something resembling a statement of claim will generally be necessary.

A person, not a party to a case, who seeks to intervene in a case (except a bankruptcy case or if entitled to do so under r 6.06, eg Attorney-General) must file an Application in a Case and an affidavit setting out the facts relied on to support the application. The affidavit must:

- include a statement of the person's relationship (if any) to the parties, and
- attach a schedule setting out any orders the person seeks if the court grants permission to intervene (r 6.05).

Once a person has intervened that person is a party with all the rights and obligations of a party. A party may apply to be removed as a party to a case by filing an Application in a Case.

In *Beeson and Spence* [2007] FamCA 200, the husband was declared bankrupt in April 2005 after judgment was entered against him for \$64 million plus costs and interest. The trustee in bankruptcy chose not to intervene in the *FLA* proceedings. Moore J allowed the husband to retain over \$1.4 million of superannuation, being 40% of the total pool. Moore J considered the wife's entitlements to be 55%, but gave the wife the 60% offered to her by the husband.

If the trustee had been a party, the trustee may have successfully argued that the additional 5% property should have gone to the bankrupt and that the husband/trustee should receive some non-exempt property. There would then have been funds to pay to the creditors.

However, it was a risky case to run. The husband was only able to retain all his superannuation by succeeding in a s 106B *FLA* application to set aside a deed varying the terms of a discretionary trust. Possibly, the trustee and the creditors weighed up the costs and risks of the proceedings and considered them too great.

In *Sresbodan and Sresbodan* [2009] FamCA 831 the husband's trustee in bankruptcy applied to join the proceedings. Watts J said (at paras 2-5):

The trustee has a right to be joined as of right pursuant to s 79(11)... if the court is satisfied that the interests of the bankrupt creditors may be affected by the making of an order under s 79...

Counsel for the trustee conceded that there is no question in this case that the creditors will eventually be paid. The trustee in bankruptcy will inevitably receive by way of a s 79 order an alteration of property which will more than adequately satisfy the current creditors. The question however is that if the husband is left to prosecute his application how long that will take and I agree with the trustee that the Court would lack confidence in the matter being expeditiously dealt with.

The history of this matter would indicate that if the husband is left to his own devices the creditors could have no confidence that the matter will be resolved in a timely manner.

The other reason why the trustee should be joined is that the husband's property is, of course, currently vested in the trustee and the wife's application is that she receive more than one half of that property.

Bankrupt's standing in *FLA* proceedings

A bankrupt loses the right to make submissions regarding vested bankruptcy property if a trustee in bankruptcy is a party to property settlement proceedings. The bankrupt must seek the leave of the court to make submissions (s 79(12)). Leave can only be granted in exceptional circumstances (s 79(13)). The bankrupt can, however, as of right, make submissions about property which has not vested, such as superannuation. These submissions may indirectly deal with vested property.

In *Reua and Reua* [2008] FamCA 1038 Stevenson J found that there were "exceptional circumstances" because:

1. There was no opposition to the granting of leave by the wife and the trustee in bankruptcy.
2. The husband sought relief in respect of non-vested property so he was a participant in the proceedings anyway.
3. The husband had knowledge of the circumstances in which many of the unsecured debts were incurred. Although the husband's evidence was useful to the court and the trustee, the bankrupt could have been a witness without being a party.

None of these seem to be "exceptional" circumstances in the sense otherwise used in the *FLA*.

In *Pacelli and Hopkinson* [2010] FMCAfam 1248, the wife and the husband's trustee in bankruptcy entered into final consent orders as to property. The orders omitted to deal with the husband's superannuation interest of about \$13,000. The bankrupt's main argument that

he had standing was that he was a “a person affected” by a s 79 order and that the order could be set aside under s 79A(1)(a) as there had been a failure to disclose relevant information.

Burnett FM found that the pre 2005 law that s 79 rights of a bankrupt were a personal right was unaffected by the bankruptcy and still applied with respect to property which had not vested in the trustee. The argument that, as a matter of construction, s 79A(5) specifically excluded a bankrupt from pursuing rights in respect of non-vested property was rejected.

Burnett FM said (at paras 36-7):

It is not to the point that the trustee would not enjoy any greater outcome in the s 79 *FLA* application. The fact remains that on the applicant’s case, the respondent is getting a sum which is less than it ought to have been by reason of the omission of the applicant’s interest in the superannuation fund.

In my view, the applicant is affected by the orders, even if the interest is not adverse. It follows, that he is entitled to be heard and has standing under s 79 *FLA*. However, his standing is limited to his interest in the superannuation fund.

Arguably, the trustee may have done better if the superannuation was included in the pool and the bankrupt’s interest was split 100% to the wife. Burnett FM suggested, however, that if the wife formally abandoned any claim to the bankrupt’s superannuation and the bankrupt persisted in his s 79A claim an application for security for costs by the trustee and the wife would be viewed favourably by the court.

In *Freer and Freer* [2008] FamCA 131 the bankrupt sought that the Family Court proceedings be stayed pending the final determination of Supreme Court proceedings which appeared close to resolution. There was, however, no evidence of the likely settlement and whether the settlement sum would be sufficient for the husband to pay out his judgment debts and obtain an annulment of his bankruptcy. Although any damages received in the Supreme Court proceedings might enlarge the asset pool, the wife did not seek to claim against them.

Strickland J said (at para 17):

Thus the effect of making the orders sought by the husband would provide no advantage to the husband in terms of the asset and liability pool. The only advantage is that he would be able to run his own case. However, there would be significant prejudice to the wife. I am told that, in effect, the assets for division are the former matrimonial home and shares in accompany. I am told ... that the husband resides in the home ... and thus the wife would be prevented from accessing one of the major assets of the marriage which would be the subject of the property settlement proceedings for many years to come. In the meantime, though, on that scenario the husband would presumably continue to reside in the matrimonial home and he would be the one who would enjoy the benefit of that asset.

Costs

In *FLA* proceedings costs do not normally follow the event, unlike in other courts. The main provisions of s 117 are:

- (1) Subject to subsection (2), subsection 70NFB(1) and sections 117AA, 117AB, 117AC and 118, each party to proceedings under this Act shall bear his or her own costs.
- (2) If, in proceedings under this Act, the court is of opinion that there are circumstances that justify it in doing so, the court may, subject to subsections (2A), (4) and (5) and the applicable Rules of Court, make such order as to costs and security for costs, whether by way of interlocutory order or otherwise, as the court considers just.
- (2A) In considering what order (if any) should be made under subsection (2), the court shall have regard to:
 - (a) the financial circumstances of each of the parties to the proceedings;
 - (b) whether any party to the proceedings is in receipt of assistance by way of legal aid and, if so, the terms of the grant of that assistance to that party;
 - (c) the conduct of the parties to the proceedings in relation to the proceedings including, without limiting the generality of the foregoing, the conduct of the parties in relation to pleadings, particulars, discovery, inspection, directions to answer questions, admissions of facts, production of documents and similar matters;
 - (d) whether the proceedings were necessitated by the failure of a party to the proceedings to comply with previous orders of the court;
 - (e) whether any party to the proceedings has been wholly unsuccessful in the proceedings;
 - (f) whether either party to the proceedings has made an offer in writing to the other party to the proceedings to settle the proceedings and the terms of any such offer; and
 - (g) such other matters as the court considers relevant.

Cases involving bankruptcy often increase costs. There may be three parties or more, and the bankrupt is usually unrepresented thus increasing the length of hearings and making negotiated settlement of issues on an interim and final basis less likely. If the bankrupt is involved in the proceedings, it is usually either with the objective to obtain an annulment or for a purpose which is unable to be ascertained. In *Rand and Rand* [2006] FamCA 1530, the parties were the husband, the wife, the husband's trustee in bankruptcy and eleven other respondents. In *Petresca and Petresca (No 2)* [2008] FamCA 1238 the bankrupt was ordered to file responding material and successfully sought several adjournments seeking further time to comply.

In *Hopkinson and Hopkinson and Trustee for the bankrupt estate of Mr Hopkinson (No 2)* [2010] FamCAFC 246 May J considered an application by the trustee for the bankrupt to pay his costs in relation to an appeal made by the bankrupt (not the *Pacelli* case referred to earlier

in this paper, but another hearing involving the same parties). The appeal was abandoned by the bankrupt. Her Honour refused to make an order for costs due to:

- The history of the matter
- No understanding of the bankrupt's current financial position
- No understanding of matters relevant to the bankruptcy such as when it was likely to end
- No matters relevant to a costs order being made under s 117(2) were submitted
- There was proper reason for the filing of the notice of appeal
- The notice of discontinuance was filed without delay

In *D and D (Costs) (No 2)* [2010] FamCAFC 64 there was no question that the husband had standing to be heard in the substantive appeal despite the fact that he was bankrupt. The prospect of there being no real property was real at all material times. The wife and the husband's trustee in bankruptcy were concerned that any order for costs against the husband would deplete the bankrupt estate. The trustee unsuccessfully argued that the husband's solicitors should be liable for the costs order. The Full Court of the Family Court did not agree that the costs order depleting the bankrupt estate was a reason to decline to make an order for costs.

In *Nelson and Perry* [2011] FMCAfam 239 the Federal Magistrate permitted some limited inquiry by the wife under s 179 BA about the trustee's conduct but the wife's position was that the remuneration and costs of the husband's trustee were excessive and this issue was at the core of her allegations of misconduct. Hartnett FM said (at para 44):

The hearing was not legitimately a taxation of the trustee's costs. It became clear that there was no prima facie evidence before me that the trustee had acted improperly or unethically in the work carried out by him. There is in place a statutory regime ... which could have, and should have been pursued by the wife (and still could be) in the event that she had a complaint. The Trustee indicated in the running of the matter that the bankrupt had, in fact, made such complaint and that the hearing of the bankrupt's complaint as to his fees was pending. The wife declined to seek as adjournment until a time after the resolution of that application or, indeed, any application that she may wish to bring which might have produced an increase in the asset pool. Thus those claims which went to, in effect, a taxation of the Trustee's fees the Court declined to allow cross-examination in relation to.

The trustee had already received \$110,000 from the sale of one property. The wife objected, but could not establish that the trustee had acted improperly. The pool was about \$150,500 consisting of \$139,500 from the sale of a second property and the wife's \$13,000 of superannuation. The trustee sought that the net proceeds of sale be divided 20% to the trustee

and 80% to the wife. It was relevant to the Court that funds received by the Trustee would be applied to costs and expenses, leaving nothing for the benefit of the creditors. Hartnett FM relied on Ward J in *In the matter of International Art Holdings Pty Ltd (admin apptd); International Art Holdings Pty Ltd (admin apptd) v Adam* [2011] NSWSC 164 and refused to add back to the pool the monies already received by the trustee. However, she ordered that the net proceeds of sale of the second property be given wholly to the wife. She found (at paras 58-9) that:

Looking to the matters required to be considered in s 75(2) of the *Family Law Act* the Court finds the wife to work on a full-time basis as an account manager earning approximately \$1,200 per week gross. The wife continues to have the sole responsibility of the children of the marriage and meet all expenses associated with their care. The husband makes no meaningful contribution to the support of the children and remains on unemployment benefits. The wife has re-partnered and lives with her partner, [name omitted]. She has done so since September 2009. This arrangement has provided some measure of financial and emotional support to her but the ongoing financial and emotional dependency of her children upon her cannot be underestimated. The husband's indebtedness to the Australian Taxation Office is not large but cannot be met out of the estate given the remuneration and costs quantum owed to the Trustee. The wife had no knowledge of nor gained any benefit from the husband's non payment of taxation. The Trustee has already received the sum of \$110,000 approximately and the wife's entitlement outweighs any claim of a further payment to the bankrupt estate.

Thus the wife requires an adjustment of the asset pool on the basis of contributions and future needs in total measure such that she should receive 100% of what remains as assets of the parties and which represents a relatively small pool.

The Court's orders were:

1. That all of the net sale proceeds of the real property situate at and known as Property F in the State of Victoria currently held in the trust account of the solicitors for the wife, including interest, be paid to the wife forthwith.
2. That the wife be indemnified with respect to any costs incurred by the first respondent of whatsoever nature or kind with respect to:
 - (a) these proceedings; and/or
 - (b) any costs of whatsoever nature or kind incurred in the administration of the bankrupt estate of the second respondent.

In *West and West* [2007] FMCA fam 681 the trustee had difficulty obtaining co-operation from the bankrupt. The wife offered to pay the primary debt of about \$8,000 but not the costs of about \$60,000. O'Sullivan FM found the costs were disproportionate to the debt and the property pool although the costs were calculated to include both the petitioning creditor's costs and the trustee's costs. Including the costs as part of the debts reduced the net pool by almost 25%. The Federal Magistrate was not referred to any authority that required the

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interests of the trustee to be taken into account, but only the interests of the creditors. He did not distinguish between the petitioning creditor's costs and those incurred by the trustee. He ignored the order that the bankrupt pay the petitioning creditor's costs of the bankruptcy proceedings. He found the trustee in bankruptcy was not a "creditor" within s 75(2)(ha).

Just as orders for costs are rare in the Family Court, so are orders for security for costs. They are made under s 117 and the factors listed in s 117(2A) must be considered. Butler J in *Brown and Brown; Eley and Henty (Interveners)* (1991) FLC 92-265 said (at p 78,778):

security orders prevent abuse of Court process by inter alia preventing impecunious persons from litigating without responsibility...

Generally orders are made where the defendant is an unwilling participant in the litigation and should not be prejudiced by the plaintiff's lack of funds... But the Court must carefully balance this consideration against the possibility that the plaintiff might be shut out or unfairly dealt with if security is ordered...

It is of essential importance to consider as far as possible whether the plaintiff's shortage of funds has been brought about as a consequence of the defendant's conduct of which the plaintiff complains. If so it would be unfair to require the plaintiff to provide security for the defendant's costs...

While there is a strong social trend that litigants short of funds should have their day in Court without suffering any disadvantage caused by lack of means, the fact that an appellant will be unable to pay the costs of the appeal if the appeal fails is a special circumstance where the appellant should provide security for costs...

He ordered that the husband and the wife each provide \$750 as initial security and gave the trustee liberty to make further applications for security for costs.

What should a trustee do?

The 2005 Act is often seen as disadvantageous to the trustee. The trustee cannot bring a s 79 *FLA* application as a means of trying to enlarge the assets in the bankrupt estate available for creditors. The trustee is often responding to an application by a non-bankrupt spouse to receive some of the property vested in the trustee. The trustee is usually unable to improve its position. To protect or improve its position the trustee may try to:

- have the bankrupt's debts paid from the total property pool prior to interests being adjusted between the non-bankrupt spouse and the trustee
- retain the property which was owned by the bankrupt at the date of the bankruptcy and vested in the trustee upon the bankruptcy

- have the bankrupt's superannuation split so that the non-bankrupt spouse takes a greater share of non-exempt assets (should this be exempt assets?) and more property is available to pay creditors
- rely on a constructive trust or *Cummins* type argument
- have a transaction set aside under s 106B(1) or 106B(1A) *FLA*
- have an order made that a Registrar be appointed to sign documents in the name of the bankrupt pursuant to s 106A *FLA* e.g. *Picken and Picken (No 5)* [2008] FamCA 902
- have an order made that a bankrupt vacate property and for a warrant to be issued under r 20.54 *Family Law Rules* authorising the Marshal of the Family Court or his delegate to enter the property and obtain vacant possession e.g. *Picken and Picken (No 5)* [2008] FamCA 902
- use s 35A(1), (2) and (3) *BA* to try to improve its position. This section allows a proceeding which is pending in the Federal Court on the application of a party to the proceeding or of the Federal Court's own motion, to be transferred to the Family Court with the consent of the parties to the proceeding. This gives the Family Court jurisdiction to hear and determine the Federal Court proceeding and grant remedies not otherwise within its jurisdiction.

Practical steps the trustee can do include:

1. Gather as much of the evidence relevant to the first three steps as possible. For example:
 - Value of superannuation and other exempt property of both parties
 - Contributions
 - Needs of parties
2. Look at the timing of debts - pre or post-separation?
3. Look at the nature of debts and the extent to which the non-bankrupt spouse benefited.
4. Consider whether an application should be made to set transactions aside. If so, under which Act?
5. Consider the size of the pool relative to the s 75(2) factors.

6. Look at size of total debts (including trustee's fees and expenses) relative to size of pool.
7. Consider the costs, potential benefits and potential risks of becoming a party.

Conclusion

Parties to the marriage and trustees in bankruptcy need to remember that the *BA* still applies and that the trustee can use *BA* principles to protect and enlarge its interests. If a matter is transferred from the Federal Court, the Family Court can grant the same remedies as the Federal Court otherwise could. The claw back provisions, such as s 120 and 121 *BA* and a *Cummins* type argument (eg. *Pascoe and Nguyen* [2007] FMCA 194) are available. If the proceedings are in the Federal Magistrates Court, that Court can automatically exercise jurisdiction under both Acts.

The Family Court has the power to make orders such as:

- that property which vested in the trustee at the date of bankruptcy be transferred to the non-bankrupt spouse
- that a debt which is part of the bankruptcy be paid from property which has not vested in the trustee in bankruptcy
- that the non-bankrupt spouse receive some or all of their entitlements in superannuation so that there is more non-exempt property available for the trustee

The insertion of s 75(2)(ha) means that in the 4-step process under s 79, after considering the contributions made by each of the parties to the marriage, the interests of creditors is one of the factors to be considered under s 75(2). In practice though, it appears to be given no more weight than the other factors and creditors may lose out against a non-bankrupt spouse with significant s 75(2) factors such as being on a low income with young children.

At some stage the Full Court will need to reconsider *Kowaliw* and give clearer guidance as to which debts are "debts of the marriage" which should be paid from the property of the parties when calculating the net pool. FM Walters' paper provides helpful assistance in the meantime.

On the face of it, since the 2005 Act, the Family Law Courts are better able to take into account the interests of the trustee in bankruptcy in determining applications for a property

settlement or spousal maintenance. It more frequently hears from any trustee in bankruptcy. Timing is less important. If *FLA* orders are made without proper notice to creditors or a trustee in bankruptcy, they can be set aside more easily than in the past. However, in practice, the trustee has a lot to lose in *FLA* proceedings. The *BA* claw-back provisions and *Cummins* offer trustees in bankruptcy more hope and opportunity than the 2005 Act does. It is likely that in cases with significant asset pools and significant debts (e.g. *Cummins* and *Lemnos*), trustees or creditors with deep pockets such as the Australian Taxation Office, will be willing to fund the proceedings and pursue claims under the *BA* rather than rely on the *FLA*.

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