Bankruptcy, financial agreements and the rights of creditors

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The Full Court of the Family Court of Australia in *Grainger & Bloomfield*[1] considered the standing of a creditor to apply to set aside a financial agreement after the debtor spouse became a bankrupt. Shortly prior to the bankruptcy, the bankrupt spouse transferred her legal title in the home to her husband, which left the creditor unable to recover as there were little or no assets in the bankrupt estate.

Background Facts

Mrs Grainger purchased an unencumbered property at E in Queensland in 2007 with funds provided by her husband, Mr Grainger. From 2008, Mrs Grainger borrowed amounts totalling $2.6 million from a bank. The loan was secured by a mortgage over the E property.
As a result of proceedings in the Queensland Supreme Court between Mrs Grainger and Ms Bloomfield (arising out of business arrangements between them), Mrs Grainger became a judgment debtor to Ms Bloomfield for $2,100,000 in late 2011. On or about 14 October 2012 a bankruptcy notice was served on Mrs Grainger in respect of that judgment debt.

On 1 November 2012 Mr and Mrs Grainger entered into a financial agreement under s 90C (during marriage) of the *Family Law Act 1975* ("FLA"). Under the agreement, Mrs Grainger transferred her interest in the E property to Mr Grainger subject to the mortgage.

Mrs Grainger was served with a creditor's petition in December 2012. She became a bankrupt on a debtor's petition in January 2013. Ms Bloomfield lodged a proof of debt in respect of her judgment debt with Mrs Grainger's trustee in bankruptcy.

Applications

In January 2014 Ms Bloomfield filed an initiating application in the Federal Circuit Court naming Mr and Mrs Grainger as respondents and seeking orders under s 90K of the FLA to the effect that:

- under s 90K(1)(aa)(i), the financial agreement between Mr and Mrs Grainger be set aside;

[1] [2015] FamCAFC 221

- under s 90K(3), Mr Grainger transfer the E property (free of the mortgage) to the bankrupt estate of Mrs Grainger, or alternatively pay to that estate a sum equal to the market value of the property as at the date of transfer.

Ms Bloomfield also sought a declaration to the effect that the agreement was not binding under s90G of the FLA.

Mr Grainger sought that all, or parts, of the statement of claim filed by Ms Bloomfield in support of her initiating application be struck out, or alternatively that the proceedings be dismissed (in whole or in part).

Neither Mrs Grainger or her trustee in bankruptcy took any part in the proceedings before Judge Cassidy or before the Full Court.

Proceedings before the trial judge

On 24 September 2014, Judge Cassidy of the Federal Circuit Court made orders striking out:

- certain paragraphs of the statement of claim (being those in support of the claim for the declaration that the financial agreement was not binding).
- the paragraph of the initiating application in which that declaration was sought.

Ms Bloomfield's application, to the extent that it sought orders under s 90K(1)(aa) and s 90K(3), remained on foot. Judge Cassidy also ordered a transfer to the Family Court.

The appeals and leave to appeal

The Full Court of the Family Court granted both parties leave to appeal against the interim orders. Mr Grainger said that three questions were raised. Ms Bloomfield phrased the three questions differently, but they were similar in substance. Mr Grainger's questions were:

Q1 Where a party to a financial agreement has become bankrupt, does a creditor of the bankrupt have standing to apply to set aside a financial agreement or seek relief under s 90K(3)?

Q2 Does the power in s 90K(3) to make orders adjusting the rights of persons extend to adjustments other than for the purpose of substantially restoring the position existing before the financial agreement?

Q3 In seeking to set aside a financial agreement under s 90K may a creditor rely on any grounds other than the ground specified in s 90K(1)(aa)?

The trial judge answered Q1 as yes, Q3 as no and refused to determine Q2.

Relevant statutory provisions

Section 90K(1) sets out the grounds for setting aside a financial agreement. The relevant subsections relied upon by Ms Bloomfield were:

> "A court may make an order setting aside a financial agreement ... if, and only if, the court is satisfied that:
>
> (a) the agreement was obtained by fraud (including nondisclosure of a material matter); or
>
> (aa) a party to the agreement entered into the agreement:
> (i) for the purpose, or for purposes that included the purpose, of defrauding or defeating a creditor or creditors of the party; or
> (ii) with reckless disregard of the interests of a creditor or creditors of the party; or …
>
> (b) the agreement is void, voidable or unenforceable …"

A "creditor" for the purposes of s 90K(1)(aa) is defined in s 90K(1A) to include "… a person who could reasonably have been foreseen by the party as being reasonably likely to become a creditor of the party".

Also relevant was s 90K(3), which deals with the rights of a party or "any other interested person" in the event that a financial agreement is set aside:

> "A court may, on an application by a person who was a party to the financial agreement that has been set aside, or by any other interested person, make such order or orders (including an order for the transfer of property) as it considers just and equitable for the purpose of preserving or adjusting the rights of persons who were parties to that financial agreement and any other interested persons".

Jurisdiction in relation to married or formerly married persons is conferred under the "matrimonial causes".[2] The definition of “matrimonial cause” is in s 4(1). The definition includes:

> “(eab) third party proceedings (as defined in section 4A) to set aside a financial agreement;”

The definition of “third party proceedings” in s 4A for the purposes of paragraph (eab) is proceedings between:

> "(a) any combination of:
> (i) the parties to a financial agreement; and

[2] s 31(1)(a) and s 39 FLA

(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, a "creditor" is:

"(a) a creditor of a party to the financial agreement; or
(b) 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 the financial agreement."

and a government body is:

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

Therefore, for a court to have jurisdiction in proceedings to set aside the agreement under s 90K(1)(aa), the proceedings must be between the parties to the agreement and either a creditor of one of those parties or "a government body acting in the interests of a creditor". It was not contended before the Full Court that a trustee in bankruptcy was within the definition of "a government body" in s 4A.

The FLA was amended in 2003 to give a creditor standing to apply to set aside a financial agreement. Sections 90K(1)(aa) and 90K(3) (and related s 4A and new paragraph (eab) of the definition of "matrimonial cause" in s 4(1)) were inserted into the FLA. These amendments were intended to overcome the problems raised in *ASIC and Rich & Rich*,[3] by clarifying the rights of a creditor to apply to set aside a financial agreement.

Significant amendments were made to both the FLA and the *Bankruptcy Act 1966* ("the BA") in 2005. Two of the three objectives of the amendments, according to the Explanatory Memorandum, were to:

"(a) address longstanding issues concerning the interaction between family law and bankruptcy; and
(b) prevent the misuse of financial agreements as a means of avoiding payment to creditors …".

[3] (2003) FLC 93-171; [2003] FamCA 114

The amendments included:

- giving the Family Law Courts the power to make orders with respect to vested bankruptcy property in relation to a bankrupt party to a marriage;
- allowing a trustee in bankruptcy to be a party to s 79 proceedings;
- introducing a new act of bankruptcy where a party became involved as a result of a transfer of property pursuant to a financial agreement.

The appeal

Question 1: Does a creditor of a bankrupt have standing under s 90K(1)(aa) or s 90K(3)?

The first, and apparently novel question was whether a creditor of a bankrupt party remained "a creditor" for the purpose of s 90K(1)(aa) or an "interested person" for the purpose of s 90K(3), and thus could apply for relief under those sub-sections. It was accepted by the parties that if a person had standing as a creditor to apply to set aside an agreement under s 90K(1)(aa), that person was also an "interested person" entitled to apply for orders under s 90K(3).

Ms Bloomfield phrased this question as whether a "creditor" entitled to commence a third party proceeding was a "creditor" in the broad or ordinary meaning of that word, or whether it was limited to a creditor before a sequestration order was made against that party.

Mr Grainger argued that on Mrs Grainger's bankruptcy, Ms Bloomfield ceased to be a "creditor" within the meaning of s 4A or an "interested person" within the meaning of s 90K(3), and accordingly ceased to have standing for the purposes of an application under either s 90K(1)(aa) or s 90K(3). Mr Grainger relied on the specific provisions of the BA, and the public policy considerations underlying it, for his essential submission that once bankruptcy intervened, no action could be taken by a creditor against the debtor to enforce the creditor's debt. The creditor's rights were confined to proving the debt in the bankruptcy, to sharing in the distribution of the bankrupt's estate, and to ensuring the proper administration of the estate by the trustee. It was for the trustee to take action, where appropriate, to recover property the bankrupt disposed of prior to the bankruptcy. The creditor was not an "interested person" for the purposes of s 90K(3), because any relief that might be obtained on the setting aside of the agreement benefited the whole of the bankrupt estate, not just as an individual creditor.

Although not discussed in detail in the judgment, orders are rarely made allowing creditors to be or continue as parties to, proceedings (under the FLA or otherwise), or to remain parties,

following the bankruptcy of one of the parties for the purposes associated with the recovery of the debt. Generally, as envisaged by s 58 and s 60 BA, fresh proceedings cannot be commenced against the bankrupt and existing proceedings are stayed. Section 58(3) provides:

> "Except as provided by this Act, after a debtor has become a bankrupt, it is not competent for a creditor:
> (a) to enforce any remedy against the person or the property of the bankrupt in respect of a provable debt; or
> (b) except with the leave of the Court and on such terms as the Court thinks fit, to commence any legal proceeding in respect of a provable debt or take any fresh step in such a proceeding."

Section 60(1) provides:

> "The Court may, at any time after the presentation of a petition, upon such terms and conditions as it thinks fit: …
> (b) stay any legal process, whether civil or criminal and whether instituted before or after the commencement of this subsection, against the person or property of the debtor:
> (i) in respect of the non-payment of a provable debt or of a pecuniary penalty payable in consequence of the non-payment of a provable debt …."

Leave to continue or commence proceedings against a bankrupt can only be given to the creditor by a court exercising bankruptcy jurisdiction under s 27(1) BA. There is, therefore, an absolute bar on the enforcement of a remedy under s 58(3)(a) BA except as otherwise provided in the BA.[4] The meaning of the proviso, which is the only "out" for the creditor, do not appear to have been tested despite there being a significant number of cases on the meaning of s 58(3)(b) where the reliance on any exception could have been pleaded in the alternative. For example, in *Fraser v Commissioner of Taxation & Official Trustee*[5] the creditor succeeded in her application under s 58(3)(b) because her s 79A application under the FLA was characterised as a "legal proceeding" not "the enforcement of a remedy".

The application of *Fraser* was not discussed in *Grainger*, although it was referred to briefly.

Ms Bloomfield argued that on the bankruptcy of the debtor the status of a creditor as a creditor did not change; rather only the remedies available to the creditor to enforce the debt change by virtue of the provisions of the BA. A creditor remained a creditor for purposes of s 90K(1)(aa) and an “interested person” for the purposes of s 90K(3) of the FLA.

The Full Court said that the definitions of “creditor” in s 4A(2) and in s 90K(1A) did not assist it to answer the question. The Full Court referred to the revised Explanatory Memorandum to the

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[4] See *Clyne v Deputy Commissioner of Taxation* (1984) HCA 44
[5] [1996] FCA 1701

Bankruptcy and Family Law Legislation Amendment Act 2005 and said that s 79(10A) qualified the operation of s 79(10) so that a creditor could not be a party to property settlement proceedings if a party to the proceedings was a bankrupt (to the extent to which the creditor's debt was a provable debt under the BA) or was a debtor subject to a personal insolvency agreement (to the extent to which the creditor's debt is covered by the personal insolvency agreement). The amendments aimed to ensure that the trustee in bankruptcy represented the interests of all creditors in property settlement proceedings.

When Pt VIIIAB, which concerns financial matters relating to de facto relationships, was inserted into the FLA by the *Family Law Amendment (De Facto Financial Matters and Other Measures Act) 2008* (Cth), it contained similar provisions in s 90SM to s 79(10) and s 79(10A). Pt VIIIAB also provided for financial agreements between persons in de facto relationships, which were of virtually identical effect to the provisions of Pt VIIIA, including s 90UM which provides for the setting aside of financial agreements in identical circumstances to those in s 90K in relation to creditors. The Full Court concluded:

> "Given these various legislative initiatives, the better view must be that it is the legislative intention that, unlike the position of a creditor in relation to property settlement proceedings, the entitlement of a creditor to apply to set aside a financial agreement under s 90K(1)(aa) or s 90UM(1)(b) does not cease on the bankruptcy of the debtor, who is a party to the agreement"[6]

The Full Court found support for the conclusion that it was possible for a creditor to commence or continue proceedings against a bankrupt in respect of a provable debt in s 58(3) of the BA which provides:

> "Except as provided by this Act, after a debtor has become a bankrupt, it is not competent for a creditor ...
> (b) except with the leave of the Court and on such terms as the Court thinks fit, to commence any legal proceeding in respect of a provable debt or take any fresh step in such a proceeding."

The Full Court recognised that the court's leave was necessary for a creditor to commence proceedings to set aside a financial agreement under s 90K(1)(aa) (or s 90UM(1)(b)), but that did not detract from the conclusion that the BA itself envisaged a creditor commencing or continuing litigation against a bankrupt in respect of a provable debt.

The Full Court concluded that Ms Bloomfield had standing as a creditor to apply under s 90K(1)(aa) of the FLA to set aside the agreement, and also under s 90K(3) of the FLA to seek ancillary orders (subject to a grant of leave under s 58(3)(b) of the BA).

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[6] at para 46

Question 2: The extent of the power in s 90K(3)

The second question related to the extent of the power under s 90K(3) of the FLA which provides:

> "A court may, on an application by a person who was a party to the financial agreement that has been set aside, or by any other interested person, make such order or orders (including an order for the transfer of property) as it considers just and equitable for the purpose of preserving or adjusting the rights of persons who were parties to that financial agreement and any other interested persons."

Mr Grainger contended that the power in s 90K(3) "is consequential on the setting aside of a financial agreement, in order to reverse transactions affected under that agreement, or to make adjustments to achieve a restoration in substance" and it did not permit a creditor to prosecute other causes of action as between the husband and wife or third parties.

Ms Bloomfield contended that the power in s 90K(3) was a power "to make such orders as it considers just and equitable for the purpose of preserving or adjusting the rights of the parties to the financial agreement or other interested persons" and was not limited in the way the appellant contended.

In support of the more restrictive interpretation of s 90K(3), Mr Grainger relied on the decision of Burnett FM (as his Honour then was) in *Reamy & Milne*.[7] In *Reamy*, judgment creditors of a party to a de facto relationship sought to set aside a financial agreement between the parties to the de facto relationship (entered into at the time of the trial which resulted in the judgment debt) pursuant to s 90UM(1)(b) of the FLA. Section 90UM(1)(b) is in virtually identical terms to s 90K(1)(aa). Similarly, s 90UM(6) is in virtually identical terms to s 90K(3).

Burnett FM refused the application of the parties to the de facto relationship for summary dismissal of the creditors' application saying:

> "In conclusion I consider s 90UM gives rise to a discretion in that the relief contended for cannot be automatically provided upon satisfaction of the requisite intention. From the material it appears that the applicants have demonstrated a prima facie case and sufficiently strong to resist an application for summary dismissal. The evidence however is not sufficient to warrant the relief contended for although further inquiry may establish such other facts as are necessary to support the inference."[8]

[7] [2012] FMCAfam143
[8] at para 44

Mr Grainger contended that his Honour held, correctly in his opinion, that the power in s 90UM(6) was a “discretionary power for restoring the parties to the former status quo”, while Ms Bloomfield contended that if his Honour did so hold, he was wrong in law and his decision should be overturned.

At trial, Judge Cassidy appeared to depart from the approach taken by Burnett FM in *Reamy*. Mr Grainger submitted that setting aside the agreement would return the parties to a status quo where the wife’s trustee in bankruptcy would take the E property encumbered with a mortgage and that the utility of proceeding was not obvious in terms of a remedy for the creditor. Ms Bloomfield argued that s 90K(3) was broader. Cassidy J considered that while Burnett FM’s reasoning was attractive and, unless it was clearly wrong, it was likely to be applied by other judges in relation to s 90UM(6), the section under consideration was s 90K(3). It was unclear why he distinguished s 90K(3) from s 90UM(6), as the wording is in virtually identical terms. He found that the analysis in *Reamy* was not determinative of the issues in *Grainger*. It was an issue that should be taken to a hearing to fully explore submissions on the extent of the power under s 90K(3).

Furthermore, the trustee in bankruptcy was still a party to the proceeding even though he had elected not to participate in that part of the proceeding. Cassidy J did not consider that she could give summary judgment on the basis that s 90K(3) was a power limited to returning the parties to their positions prior to the agreement and therefore the orders the applicant sought would not be available. Ms Bloomfield was entitled to argue the breadth of the s 90K(3) power at the trial.

To the extent that Cassidy J considered that there was some difference between s 90UM(6) and s 90K(3), the Full Court pointed out that she was in error. Otherwise, Cassidy J did not err in the approach she took to s 90K(3). The Full Court said, therefore, that the trial judge was not wrong in permitting, in the exercise of her discretion, the s 90K(3) issue to go to trial.

The Full Court thought it might be useful for it to make observations about s 90K(3) (and its counterpart s 90UM(6)) given that it appeared "that to date there has been no decision of any court in relation to the scope of the powers in s 90J(3)”.[9] The Full Court observed that s 90K(3) had some similarities to s 87(9)(b) of the FLA, which was concerned with a court’s powers when it revokes an approval by a court of a s 87 maintenance agreement. Section 87(9) provides:

> “Where the approval of a maintenance agreement under this section is revoked by a court:
> (a) the agreement ceases, for all purposes, to be in force; and

[9] at para 69

(b) the court may, in proceedings for the revocation of the approval or on application by a party to the agreement or any other interested person, make such order or orders (including an order for the transfer of property) as it considers just and equitable for the purpose of preserving or adjusting the rights of the parties to the agreement and any other interested persons;

and, in exercising its powers under paragraph (b), the court shall have regard to the ground on which it revoked the approval of the agreement".

The Full Court noted there had been little exploration of s 87(9), with the only authority it could find of any assistance being *Re Chemaisse; Federal Commissioner of Taxation (Intervener)*[10] where the Full Court observed that it was unnecessary and inappropriate to consider the wider questions raised by senior counsel for the wife relating to the interpretation of s 87(9)(b).[11] The facts involved a fraud perpetrated upon the Court and whatever may be the appropriate exercise of the discretion in other cases, there was really no other proper exercise of the discretion open to the trial judge as s 87(9)(b) specifically required the court to have regard to the ground of revocation.

The Full Court in *Grainger* considered that the "observations of the Full Court in *Chemaisse* can be read as cautioning against an over-expansive application of a provision such as s 87(9)(b) or s 90K(3). But they also suggest that the application of such a provision will depend on the particular facts of the case in which the provision is to be applied".[12]

As the facts in *Grainger* had yet to be found, the Full Court did not consider it appropriate to say more regarding the operation of s 90K(3) in the context of this appeal against a refusal of a summary dismissal order. The Full Court agreed that the primary judge was correct in refusing in the context of a summary dismissal application, to determine the scope of the preservation and adjustment powers in s 90K(3).

Question 3: In seeking to set aside a financial agreement is a creditor limited to the s 90K(1)(aa) ground?

Ms Bloomfield contended that once she had invoked the court's jurisdiction pursuant to s 90K(1)(aa) to set aside the financial agreement, she was entitled to rely on other grounds in s 90K(1) as a basis for her application to set aside the agreement, in particular the ground contained in s 90K(1)(b), being that "the agreement is void, voidable or unenforceable". She claimed that the agreement was "unenforceable" pursuant to s 90K(1)(b) as it did not comply with the requirement in s 90G(1)(b) of the FLA for each party to the agreement to have had independent legal advice about certain matters before entering the agreement, because of an

[10] (1990) FLC 92-133; [1990] FamCA 32
[11] at paras 40-41
[12] at para 72

alleged lack of independence on the part of a solicitor, Mr P, who provided advice to Mrs Grainger before she entered into the agreement. This was, in any event, a broader view of s 90K(1)(b) as agreements which do not comply with s 90G(1)(b) are found not to be binding under s 90G(1)(b), rather than set aside under s 90K(1)(b).

However, Ms Bloomfield's status in the proceedings, if she had status, was to seek orders under s 90K(1), not under s 90G(1).

Mr Grainger contended that a creditor can only challenge a financial agreement on the ground set out in s 90K(1)(aa), because of the content of the definition of "third party proceedings" in s 4A of the FLA and the reference to that definition in paragraph (eab) of the definition of "matrimonial cause" in s 4(1) of the Act. The trial judge accepted this.

The Full Court agreed and said:

> "It will be seen that an essential element of the definition of 'third party proceedings' …. We can only say that we are at a loss to understand how it can be asserted in circumstances where the statute permits a creditor of a party to a financial agreement to apply to set aside the financial agreement on one specified ground, that the accrued jurisdiction (or indeed, the associated jurisdiction which was also pressed, albeit faintly, before us) would permit the creditor to apply to set aside the financial agreement on any other ground provided in the Act.
>
> Put simply, the purpose of the accrued jurisdiction is to permit a party, or parties, to obtain all remedies available to that party, or parties, in the one proceeding in relation to a particular matter. It cannot confer on a party additional remedies under a statute that are not otherwise conferred by that statute on that party."[13]

The cross appeal was also dismissed.

Conclusion

In *Grainger & Bloomfield* the right of a creditor to apply to set aside a financial agreement after the bankruptcy of the creditor spouse was confirmed. However, the creditor was limited to arguing the s 90K(1)(aa) ground in applying to set the agreement aside and was unable to rely on s 90G(1) and argue that it was not binding as being void, voidable or unenforceable under s 90K(1)(b).

This decision has significant impact for creditors and for couples where one spouse is bankrupt. The rights of a creditor to apply to set aside a financial agreement have been confirmed by the Full Court of the Family Court to survive a spouse's bankruptcy.

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[13] at paras 84-85