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The rights of trustees in bankruptcy and s 75(2)(ha)

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Trustees in bankruptcy are often pessimistic about how they will fare in proceedings under s 79 *Family Law Act 1975* (*"FLA"*).

The recent case of *Grainger & Bloomfield* [1] is likely to increase this pessimism. The impact of s 75(2) in the determination of claims under s 79 when one party is bankrupt may be less than indicated in previous decisions of the Family Law Court.

What is the s 79 process?

The court must be satisfied that it is just and equitable to alter the legal and equitable interests of the parties in property[2]. Whilst the trustee may want an alteration of the interests in the property of the non-bankrupt spouse, in practice it is more likely that the court will find it is just and equitable to alter the interests of the parties in relation to the vested bankruptcy property. If one party is bankrupt, the interests of a bankruptcy trustee in the vested bankruptcy property can be altered[3].

When determining what alteration of property interests is appropriate, the court must consider contributions and s 75(2) factors. The s 75(2) factors are sometimes incorrectly referred to as the "future needs" of the parties, although they cover a wider range of matters including age, earning capacity, the duration of the marriage and the level of child support. The court must still consider contributions and s 75(2) factors.

How are the interests of a trustee in bankruptcy relevant to s 79?

A trustee in bankruptcy may argue that it should be considered in the determination of "legal and equitable interests" under s 79(1). Doubt has been cast, however, by the Full Court of the Family Court on whether unsecured liabilities are legal or equitable "interests" which can be altered under s 79[4]. Despite this doubt, in many cases where neither party is bankrupt, the parties and the court agree that certain debts be deducted from the gross property pool when calculating the property available for division between the parties in line with the *Biltoft & Biltoft* [5] line of authority. If the unsecured debts are taken into account in the determination of the property pool, a trustee in bankruptcy will not need to rely on the contribution assessment and s 75(2) factors, except in relation to its fees and expenses.

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[1] (2015) FLC 93-677
[2] *Stanford & Stanford* (2012) FLC 93-518
[3] (s 79(1)(b)
[4] e.g *Bevan & Bevan* (2013) FLC 93-545 and *Layton & Layton* [2014] FamCAFC 120
[5] (1995) FLC 92-614

If the debts which the trustee is seeking to be paid are not paid from the gross property pool, the trustee in bankruptcy will need to seek to retain as much vested bankruptcy property as possible, and perhaps claim property of the non-bankrupt spouse, relying on legal and equitable principles to establish the bankrupt's "interests" in property, relying otherwise on s 79, or relying on both. The opportunity to rely on legal and equitable principles is, however, beyond the scope of this article.

In relying on s 79, the trustee must establish the bankrupt's contributions and that there should be a s 75(2) adjustment in favour of the bankrupt and/or the trustee.

Problems that arise for a trustee in bankruptcy in the assessment of contributions and s 75(2) factors include:

- The bankrupt may be unco-operative and not be prepared to give any evidence to establish the bankrupt's entitlements so as to maximise the property which vests in the trustee;
- The bankrupt may be aligned with the non-bankrupt spouse and give evidence that assists the non-bankrupt spouse;
- The bankrupt may be considered by the court to have sole responsibility for the financial losses resulting in the bankruptcy. Financial losses and debts are generally shared between the parties to a relationship (although not necessarily equally), except:
    - "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
    - 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."[6].

The prospects of the non-bankrupt spouse being successful in claiming that property which has vested in the trustee should be transferred to the non-bankrupt spouse is increased by the ability of the non-bankrupt spouse to argue for an adjustment under s 75(2). The only factor among the 19 factors listed in s 75(2) which appears to be of any relevance to the trustee is s 75(2)(ha). Section 75(2)(ha) refers to the effect of any proposed order on the ability of a creditor of a party to recover the creditor's debt. The other factors favour the non-bankrupt spouse, although arguably s 75(2)(o), which is a "catch-all" provision - "any fact or circumstance which, in the opinion of the court, the justice of the case requires to be taken into account". However, it is not a true "catch-all" phrase and the *ejusdem generis* rule is applied to narrow the interpretation of s 75(2)(o) to only cover matters similar to those listed in s 75(2).

It is generally accepted that, unless the bankrupt is likely to achieve an annulment, the s 75(2) factors are not relevant to the bankrupt. The extent to which s 75(2)(ha) covers the interests of a

[6] *Kowaliw & Kowaliw* (1981) FLC 91-092 at p76,744

trustee as opposed to simply those of creditors may, however, be re-considered following the decision of the Full Court of the Family Court in *Bloomfield & Grainger*.

Examples of cases where the rights of the trustee were considered under s 75(2)(ha)

In *Pippos & Pippos*[7], debts incurred by the husband post-separation led to his bankruptcy. Burr J gave the wife 5% for 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) (the terms of any order proposed to be made under s 79 in relation to the property of the parties or the vested bankruptcy property of a bankrupt party) 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 by the husband post-separation.

In *West & West*[8] the trustee sought that the home be sold and the net proceeds of sale be divided equally between the wife and the trustees. The trustee's costs and fees were over $60,000 where the original debt was $10,000. The wife offered to pay the original debt. The wife had made the majority of the contributions to the property of the parties and the welfare of the family and the court ordered that the property (including superannuation) be divided 85%/15% in favour of the wife. The trustee was severely hampered by the absence of evidence on behalf of the husband as to his contributions.

The Federal Magistrate considered it relevant under s 75(2)(ha) that the 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 said:

> *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.*[9]

In *Lasic & Lasic*,[10] the husband's trustee in bankruptcy sought to set aside consent orders made between the husband and the wife. The pending litigation by Mr M was not disclosed to the court. The trial Judge relied on s 75(2)(ha) and 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 & Lasic*[11], the Full Court understood the trial Judge's concern that if the husband's entitlement was paid to the trustee,

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[7] [2008] FamCA 542
[8] [2007] FMCAfam 681
[9] (at para 111)
[10] [2007] FamCA 1188
[11] (2009) FLC 93-402

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. The matter was remitted for re-trial.

In *Trustee of the Property of G Lemnos & Lemnos*[12] the husband's trustee 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. Contributions were assessed as equal at the date 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 of the Family Court held that the interests of unsecured creditors did not automatically prevail over the interests of the non-bankrupt spouse, and their competing claims must be balanced 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 waste principle in *Kowaliw*[13] 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 in *Lemnos* allowed the appeal because of the trial Judge's treatment of the primary tax burden as "waste". The minority allowed the appeal because of the way the trial Judge applied s 75(2)(ha). By ordering that the wife receive 50% of the equity in the home, the trial Judge gave priority to the wife over the unsecured creditors. The unsecured creditors were owed approximately $6 million. They received the same dollar amount as the wife, or about 20% of their claims. In finding that the husband should satisfy the tax debt from his resources, the majority said that the trial Judge had already decided the issue which s 75(2)(ha) directed him to consider (the effect of any proposed order or the ability of a creditor to recover the creditor's debt) when coindiering the s 75(2) factors earlier. Both the trial Judge and the Full Court considered that the wife in *Lemnos* should share some responsibility for the primary tax.

Financial Agreements - trustee's rights to set aside

At first glance, financial agreements are, arguably, not as secure for the parties as consent orders if bankruptcy is a possibility. Transfers pursuant to court orders are protected by s 59A *Bankruptcy Act 1966* ("*BA*"), but transfers pursuant to financial agreements do not have the same protection. Consent orders have the approval of the court and, provided there has been full disclosure of the

[12] (2009) FLC 93-394
[13] (1981) FLC 91-092

debts and notice to third party creditors, they will be difficult for a trustee to set aside.

Following *ASIC v Rich*[14], amendments were made to the *FLA* and the *BA* to give greater protection to 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[15]
- It is an act of bankruptcy if a person becomes insolvent as a result of a transfer or transfers made under a financial agreement[16]
- The claw back provisions in the *BA* can be used to recover property transferred under a financial agreement[17]
- A separation declaration must be made before a financial agreement comes into force or takes effect if it relates to property or financial resources[18]

In *Official Trustee in Bankruptcy & Galanis*[19], Rees J found that the trustee in bankruptcy of a discharged bankrupt did not have standing under s 90K(1)(aa) *FLA* to apply to set aside a financial agreement made subsequent to the bankrupt's discharge. The trustee appealed. An application for the hearing of the appeal to be expedited was dismissed in *Official Trustee in Bankruptcy & Galanis*[20]. Rees J considered some of the broader questions of the respective standing of creditors and trustees in bankruptcy during bankruptcies.

Those questions were considered further by the Full Court in *Grainger & Bloomfield*[21]. For a court to have jurisdiction in proceedings to set aside the agreement under s 90K(1)(aa), the Full Court said that 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 the Official Trustee was within the definition of "a government body" in s 4A, although this was argued and rejected in *Galanis.*

Trustees and s 75(2)(ha)

Prior to *Bloomfield & Grainger*, s 75(2)(ha) *FLA* was generally read so as to include the "trustee in bankruptcy" within the term "creditors". However, other parts of the *FLA* expressly refer to

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[14] (2003) FLC 93-171
[15] s 90K(1)(aa) and 90K(1A) *FLA*
[16] s 40(1)(o) and s 40(7) *BA*
[17] s 40(1)(o) and s 120 *BA*
[18] s 90DA(1) *FLA*
[19] [2014] FamCA 832
[20] [2015] FamCAFC 212
[21] (2015) FLC 93-67

"trustees in bankruptcy", and "trustees in bankruptcy" and "creditors" in separate sections. The rights of trustees and creditors to intervene in s 79 proceedings are dealt with in s 79(11) and s 79(10) respectively. Section 79A entitles both the trustee in bankruptcy and the creditors to apply to set aside s 79 property settlement orders in certain circumstances under s 79(5) and (6) and s 79A(4) respectively.

The narrow interpretation of s 90K(1)(aa) to exclude the interests of creditors supports a narrow reading of s 75(2)(ha) to exclude the rights of the trustee in bankruptcy. The literal or ordinary meaning of s 75(2)(ha)[22] is that s 75(2)(ha) does not cover trustees in bankruptcy. As there is no ambiguity, there is no place for looking at the purposive approach[23] or the extrinsic materials[24]. The wording of the section speaks for itself, particularly where other sections of the Act expressly refer to the rights of trustees in bankruptcy.

There are, however, two possible interpretations of s 75(2)(ha) if this narrow approach is adopted:

1. As in *West* and *Lasic*, where any payment to the trustee in bankruptcy could not have resulted in any dividend being paid to the creditors, s 75(2)(ha) is irrelevant. If there is to be a dividend to the creditors rather than all monies in the bankrupt estate being used to pay the trustee's fees and expenses including legal costs, then s 75(2)(ha) is relevant;

2. As the trustee in bankruptcy is representing the interests of creditors, and the creditors do not have the right to bring proceedings to enforce recovery of their debts, s 75(2)(ha) is totally irrelevant to the s 79 process. This approach is even narrower.

Conclusion

Trustees in bankruptcy are understandably wary of how they will fare in *FLA* proceedings. The recent decision of *Bloomfield & Grainger* is likely to increase their concerns that outcomes favourable to trustees are difficult to achieve.

The wide interpretation of s 75(2)(ha) to include the interests of a trustee in bankruptcy (as representing the interests) of creditors appears inconsistent with *Grainger & Bloomfield* whether a narrower reading of s 75(2)(ha) will be adopted, and how narrow this reading will be, is unclear.

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[22] *Amalgamated Society of Engineers v Adelaide Steamship Co Ltd* (1920) 29 CLR 129
[23] s 15AA *Acts Interpretation Act 1901*
[24] s 15AB *Acts Interpretation Act 1901*