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The recent High Court decision of *Stanford v Stanford* (2012) FLC 93-518 has possible implications for trustees in bankruptcy involved in or contemplating property proceedings under s 79 *Family Law Act* ("the Act)". The facts of the case and its general implications are set out in another article by the writer on *CCH Law Chat* at *Family Law Resources http://www.lawchat.com.au/index.php/stanford-the-high-court-decision-by-jacky-campbell-forte-family-lawyers/.*

The "four step" approach which the Family Law Courts have used for many years to determine applications for alteration of property interests under s 79 was not expressly approved by the High Court, which said that whether making an order was just and equitable must be determined first, before considering the other matters in s 79. Considering "just and equitable" as a preliminary matter rather than last, as has been the practice, arguably gives greater opportunity for trustees in bankruptcy to try to retain or to recover marital property to pay debts owed by the bankrupt. The High Court also said that the existing legal and equitable interests of the parties must be identified before they can be altered. If the Family Law Courts give greater emphasis to equitable interests than it generally has done in the past, this could also assist trustees.

The *Bankruptcy and Family Law Legislation Amendment Act 2005* ("2005 Amendments") is often seen as disadvantageous to trustees. A trustee cannot institute s 79 proceedings against a non-bankrupt spouse as a means of trying to enlarge the assets in the bankrupt estate available for creditors whereas a non-bankrupt spouse can bring a s 79 application to try to increase their entitlements. The trustee is often forced to simply defend an application by a non-bankrupt spouse claiming property vested in the trustee. Only rarely can the trustee improve its position and it often goes backwards. The post-*Stanford* environment offers opportunities for trustees to seek to maintain their positions, and in some circumstances, perhaps to improve it.

The Stanford decision

The case involved an elderly couple involuntarily separated by circumstances. The wife required nursing home care and died during the course of the proceedings. The High Court upheld the husband's appeal against an order for a payment to the wife's estate after the husband's death. The majority allowed the husband's appeal primarily on the ground that the Full Court of the Family Court did not address the requirements for making orders after a party's death. The minority judgment agreed, but did not deal with the broader issues under s 79.

The High Court considered two main issues:

- Whether an order for alteration of property interests can be made under s 79 if parties are not separated or are "involuntarily" separated. The High Court majority held that a s 79 order can be made in these circumstances if it is just and equitable to do so.
- The proper approach to determining an application under s 79. The High Court majority emphasised that it is important to read and apply the Act. In particular, it warned against “conflating” the requirements of s 79 and highlighted that the court must first consider whether it is just and equitable to make the order.

As the case did not involve a “standard” separation, there is likely to be debate about the extent to which the views expressed by the High Court change the law or change the law to any significant extent.

Do parties have to be separated for s 79 orders to be made?

The High Court majority rejected the husband's argument that a s 79 order can only be made if the parties have separated. In a de facto relationship, the property rights and interests of the parties cannot be enlivened under s 90SM unless and until there is a breakdown of the relationship. Section 90SM(1) expressly only covers "property settlement proceedings after the breakdown of a de facto relationship". The High Court refused to imply this limitation into s 79.

Prior to *Stanford* there was uncertainty as to whether s 79 orders could be made in intact marriages. It is now clear that s 79 orders can be used by parties who are not separated to re-arrange their affairs with the approval of the Family Law Courts, provided it is just and equitable to do so. The High Court did not exclude from this principle, parties who are still living under the one roof. If parties provide full disclosure of creditors to the court, and in some circumstances, notice to creditors, these orders will be more difficult for a trustee in bankruptcy to set aside later than a financial agreement (which does not require court approval). The Family Law Courts require disclosure of the proceedings to creditors who may be affected by a s 79 order. Failure to do so may mean the order is at risk of being set aside under s 79A of the Act.

Although creditors and trustees in bankruptcy may be concerned about parties in intact marriages living under the one roof obtaining court approval of orders to the detriment of creditors and trustees, this is unlikely to be a significant risk. The requirement to disclose creditors to the court is a significant barrier. In addition, the requirement that it is just and equitable to make an order is likely to be more difficult to satisfy in intact marriages.

What is the proper approach to s 79?

The High Court majority gave guidance as to the proper approach to be taken to an application under s 79. It emphasised the importance of referring to the wording of the Act.

The precise wording of s 79 is therefore important to understanding the High Court's views. Section 79(1)(a) gives the court power to:

> make such order as it considers appropriate...in the case of proceedings with respect to the property of the parties to the marriage or either of them - altering the interests of the parties to the marriage in the property...

The manner in which the court must exercise the power under s 79(1) is set out in s 79(2) which provides:

> The court shall not make an order under this section unless it is satisfied that, in all the circumstances, it is just and equitable to make the order.

Section 79(4) requires the court to take into account certain matters such as contributions and the matters listed in s 75(2) (which include incomes, earning capacities, care of children and the effect of any proposed order on the ability of a creditor of a party to recover the creditor's debt) so far as they are relevant in "considering what order (if any) should be made".

The High Court warned:

> To conclude that making an order is "just and equitable" *only* because of and by reference to various matters in s 79(4), without a separate consideration of s 79(2), would be to conflate the statutory requirements and ignore the principles laid down by the Act.

At first glance this appears to be consistent with existing authority and practice, but the High Court majority rejected the notion that s 79(2) was a step to be undertaken at the end of the process. The majority said that whether it is "just and equitable" to make an order under s 79(2) arises *before* the court looks at s 79(4), rather than *after* looking at s 79(4). Section 79(2) and s 79(4) are separate inquiries and the "two inquiries are not to be merged."

In determining applications under s 79, the High Court set out three fundamental propositions that "must not be obscured":

1. Identify the *existing* legal and equitable interests of the parties as if they were not married without reference to their possible entitlements under s 79. The court must then consider whether it is just and equitable to alter the parties' interests;
2. Section 79 is a broad power, but that does not mean unguided judicial discretion or "palm tree justice";
3. There is no starting assumption that a party has the right to a s 79 order.

The pre-*Stanford* practice was to list only "property of the parties" and "financial resources". The requirement to list all legal and equitable interests seems to be broader. Equitable interests include constructive trusts, resulting trusts and estoppel interests. A broader view of "legal interests" may also be required. Contractual claims (including overseas pre-nuptial agreements and part performance of contracts) and tortious claims (e.g. personal injury claims) may be relevant.

The High Court's view makes sense as interests cannot be "altered" under s 79(1) unless the court first identifies those interests. The High Court majority said that the legal and equitable interests of the parties must be identified as if the parties were not spouses, so without reference to their possible entitlements between each other under s 79. An example arising from *Stanford* is the possibility that the wife had an interest by way of a constructive trust in the husband's home. This was an equitable interest which the Family Law Court should have identified before deciding whether or not it was just and equitable to make s 79 orders. If it had done this, the Court could have simply declared under s 78 that the wife had an interest by way of a constructive trust and the extent of that interest. It may not have decided not to make s 79 orders which altered their interests if it was not just and equitable to do so.

The "four step" approach which operated before *Stanford* and was used by the Family Law Courts and legal practitioners when making s 79 orders required the Court to:

1. Identify and value the asset pool
2. Assess contributions under s 79(4)(a)-(c)
3. Take into account the matters listed in s 79(4)(d)-(g) including the s 75(2) factors
4. Determine whether the orders are just and equitable under s 79(2).

The High Court majority in *Stanford* confirmed that the "just and equitable" requirement of s 79(2) is a separate and distinct requirement of s 79 but did not confirm the validity of the "four step" approach. Under the “four step" approach, a trustee usually achieved its best possible outcome if it successfully argued that the bankrupt's debts were liabilities to be paid from the total property pool under step 1, prior to the balance of the property pool being divided between the non-bankrupt spouse and the trustee. Trustees were often at a disadvantage in arguing steps 2 and 3, because:

- The bankrupt may have gambled or otherwise wasted assets in a manner which meant the non-bankrupt spouse had no responsibility under *Kowaliw and Kowaliw* (1981) FLC 91-092;
- The non-bankrupt spouse often denied knowledge of debts such as tax debts although the non-payment of those debts had benefited the non-bankrupt spouse and children;
- The future needs of the non-bankrupt spouse and children significantly increased the entitlements of the non-bankrupt spouse. The only matter among 19 matters listed in s 75(2) of any relevance to the trustee is s 75(2)(ha), which refers to the effect of any proposed order on the ability of a creditor of a party to recover the creditor's debt.

It is unclear how the three "fundamental propositions" outlined by the High Court majority relate to the "four step" approach (if at all). Is s 79(2) a first step or is it a threshold issue before embarking on a consideration of the rest of s 79? Is s 79(2) considered again as a separate step, with reference to s 79(4) or otherwise? Are there now only 3 steps or are there 5 steps with s 79(2) as both a first step and a fifth step and perhaps also permeating the other steps?

Did the High Court, by not referring to the "four step" process and emphasising the importance of the wording of the Act, reject the notion of a process involving structured steps?

The "just and equitable" requirement

The High Court majority considered that the just and equitable requirement of s 79(2) is "readily satisfied" if the parties are, as the result of a choice made by one or both of the parties, no longer living in a marital relationship. In those circumstances:

> It will be just and equitable to make a property settlement order in such a case because there is not and will not thereafter be the common *use* of property by the husband and wife. ... That is, any express or implicit assumption that the parties may have made to the effect that existing arrangements of marital property interests were sufficient or appropriate during the continuance of their marital relationship is brought to an end with the ending of the marital relationship. And the assumption that any adjustment to those interests could be effected consensually as needed or desired is also brought to an end. Hence it will be just and equitable that the Court make a property settlement order. What order, if any, should then be made is determined by applying s 79(4).

By contrast, an involuntary separation as occurred in *Stanford,* is not enough of itself for it to be just and equitable to make a s 79 order. The High Court said it is however, possible for a court to be satisfied that it is just and equitable to make a s 79 order if the parties are involuntarily separated.

The High Court majority said that in relation to "just and equitable" it is not possible "to chart its metes and bounds." In other words, it is not possible to chart the boundaries of what is just and equitable.

It is possible that there may be other circumstances where it is not "just and equitable" to make a s 79 order even if one or both parties initiated the separation. Possible circumstances include:

- Where the parties kept their financial affairs separate;
- After a very short relationship;
- Where an overseas pre-nuptial agreement sets out how the parties will order their affairs in the event of a separation;
- Where the rights of a third party (e.g. a creditor) will be impinged by an alteration of property interests;
- Where the recognition of legal and equitable interests is consistent with the way the parties ordered their affairs during the relationship and no further adjustment is appropriate.

A case in which the court refused to make s 79 orders in an intact marriage was *McCormack and McCormack* and *Peakes and Peakes* [2009] FMCAfam 1250. Two wives and their husbands' trustees in bankruptcy tried to obtain orders for the transfer of half

interests of properties to the wives from their husbands' trustees in bankruptcy. The aim was apparently to avoid paying stamp duty on the transfers. The wives were not separated from their husbands and the court refused to make the orders sought.

Wilson FM held (at para 4):

> It is difficult to see how those transactions arise out of the marital relationship. They arise from a commercial dealing that has failed. The fact that one party to a marriage is purchasing an interest in property (in which he or she already holds an interest) from the trustee in bankruptcy of the other does not, to my mind, mean that the proceedings arise out of the marital relationship.

The Federal Magistrate did not consider the purpose for which the s 79 orders were sought, but refused to make the orders on jurisdictional grounds. It is possible that the court could also have refused because the orders were sought for an improper purpose, being to avoid payment of stamp duty on a land transfer. Orders which have the effect of avoiding liability to a revenue authority or other creditor are likely to be orders which are not just and equitable to make in an intact marriage.

In circumstances where parties are not separated, once the court has identified the equitable and legal interests of the parties, it may not be just and equitable to make any order under s 79 altering those interests. Although not all of the following were articulated in *Stanford*, possible matters to consider include:

- Whether the needs of a party can be met by a maintenance order
- Whether future contributions by either party are likely
- Whether a separation is possible or likely
- Whether the use of "common property" continues
- The impact on the parties individually of a s 79 order
- Contributions and other matters in s 79(4) and s 75(2)
- The impact on third parties such as creditors and any trustee in bankruptcy
- Whether there is justification for a party to be relieved of the responsibility for a debt

Areas of uncertainty

There will undoubtedly be a period of uncertainty while the Family Law Courts and legal practitioners grapple with the meaning of *Stanford* and how to implement it. The practical problems include:

1. Will the court make a final determination of the legal and equitable interests of the parties and their values before assessing matters under s 79(4)? Or will parties simply state their claims? Perhaps the courts will take a different approach to matters where third parties are involved and make a more detailed examination of the legal and equitable interests of all the parties, including any third parties, before moving on to find that it is just and equitable to alter those interests? In matters involving only the parties to the marriage where they are separated and no longer have mutual

use of property, a determination of their rights without reference to s 79 may be a shorter process. It will be easier to find that it is just and equitable to alter those rights.

2. Will there be an expanded role for s 78 declarations as to property interests? In some situations, once the court makes declarations as to "existing title or rights in respect to property" under s 78 it may not be just and equitable to make s 79 orders altering those interests.
3. How will s 106B applications proceed, particularly if there is no existing property? Section 106B empowers a court to undo a transaction entered into which defeats an existing or anticipated s 79 order. The question as to whether an application under s 106B is determined before or after the court decides to exercise power under s 79 is unresolved. The requirement to consider whether it is just and equitable to make a s 79 order before embarking on the rest of the s 79 process, makes this issue more complex. Is it just and equitable to make a s 79 order when the only possible property about which an order can be made is property which has been transferred to a third party?
4. Will s 79(2) as a first step or threshold step mean that greater weight is given to the rights of third parties (including creditors), the existence of an overseas pre-nuptial agreement, to the difficulties of enforcing orders against overseas assets, the complexities of a s 106B application or the likely costs to be incurred by the parties relative to the size of the pool before a court decides that it is just and equitable to make a s 79 order?

Applying *Stanford* to recent cases

Non-bankrupt spouses who have benefited from the actions of a bankrupt spouse, whether or not they conspired together to defeat creditors, may find s 79(2) in its new format a greater hurdle to keeping assets away from the trustee. It is revealing to look at cases involving bankruptcy which pre-date *Stanford* and speculate as to how they might be decided now.

In *Commissioner of Taxation and Worsnop* (2009) FLC 93-392 the Commissioner of Taxation appealed against an order that the former matrimonial home in the wife's name be sold and the net proceeds of sale 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 and it could not be said that she ought to have known. The husband had transferred his interest in the home (then worth $1.5 million) to the wife for only $1.00 about 5 or 6 years prior to separation, at around the time the husband changed his business activities. 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. The

s 75(2) factors in her favour were off-set against the husband's tax indebtedness as a factor in the Commissioner's favour under s 75(2)(ha). Although the wife had no knowledge of the debt, which was by then about $13 million, the trial Judge gave it weight at this step.

In balancing the competing claims of the wife against the Commissioner, the Full Court found that the trial Judge 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.

The Full Court of the Family Court upheld the 50/50 split of the net pool. Although the wife had benefited from the husband's avoidance of tax, she was held to have no responsibility for the debt. Was the order that the Commissioner only receive 50% of the net proceeds of sale just and equitable? If the court had determined the parties' legal and equitable interests in the property first, would it have found that the wife was not entitled to retain a half-interest in the home? Was the finding that the wife lacked knowledge of the debt sufficient to deny the Commissioner's right to be paid when the wife had benefited from the non-payment of tax?

The rights of a non-bankrupt spouse as against a trustee were given significant weight by the High Court in *The Trustees of the Property of John Daniel Cummins v Cummins* [2006] HCA 6. The parties were not separated. The wife received an inheritance prior to the marriage which was at least partially used in their first property purchase. Later, the parties purchased vacant land as joint tenants. 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. He became bankrupt in December 2000 owing tax of about $1 million. The trustee 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. The wife said the home was worth $2 million. It was encumbered by a loan of about $950,000. The approach taken by the High Court in *Cummins* is consistent with the High Court's statements in *Stanford* that equitable interests as well as legal interests should be identified.

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 he had to consider *Cummins*, but he distinguished it. He determined the interests of the parties, not under the *Family Law Act*, but as a joint venture relying on such High Court cases as *Baumgartner v Baumgartner* (1987) 164 CLR 137, *Muschinski v Dodds* (1985) 160 CLR 583 and, particularly the mathematical approach taken to contributions in *Calverley v Green* (1984) FLC 91-565. The Court ordered that the wife receive 67% of the net proceeds of sale and that the trustee receive the balance. The trustee had sought a 50%/50% division. The reliance by the court on equitable principles and the determination of those interests is perhaps consistent with the approach that can be expected following *Stanford*.

Pre-*Stanford* cases in the Family Law Courts which have considered equitable principles and the rights of trustees include *Holden v Santosa* [2011] FMCA 251 where 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. In *Sui Mei Huen v 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. 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 depends upon the intention of the parties

In *Trustee of the Property of G Lemnos and Lemnos* (2009) FLC 93-394 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. 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 and 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 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*, 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 of the Family Court in *Johnson and Johnson* [1999] FamCA 369 where it was 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 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) which requires the court to consider the effect of any proposed order on the ability of a creditor to recover the creditor's debt. 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 20 % of their claims. By finding that the husband should satisfy the tax debt from his resources, the trial Judge had already decided the issue which s 75(2)(ha) directed him to consider under step 3.

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. Although the wife in *Lemnos* shared responsibility for the primary tax, was it just and equitable for the responsibility to be limited to the primary tax and for her not to share responsibility for the tax penalties? Would this have been decided differently after *Stanford*?

What next?

Post-*Stanford*, the trustee has increased options. In particular, it may try to rely on the existing legal and equitable interests of the parties to the marriage and the trustee, and argue that it is either not just and equitable to make an order altering those interests, or that it is just and equitable to do so.

Practical steps the trustee can do include:

1. Identify the existing legal and equitable interests as if the spouses were not married and how it can be argued that it is just and equitable to alter these interests or that it is not just and equitable to do so. Possible equitable and legal claims by the trustee against the non-bankrupt spouse outside of s 79 should not be ignored;

2. Look at contributions and other matters under s 79(4) and s 75(2);

3. Check the timing of when debts were incurred - pre or post-separation? Look at the nature of the debts and the extent to which the non-bankrupt spouse benefited as well as the non-bankrupt spouse's knowledge of them;

4. Consider whether an application should be made to set transactions aside under either the *Family Law Act* or the *Bankruptcy Act*? There are different requirements under each Act and the *Family Law Act* requirements may be easier to satisfy;

5. Assess the total debts (including trustee's fees and expenses) and the likely legal costs relative to the total assets.

Conclusion

Stanford presents opportunities for trustees to argue for a better outcome. A s 79 order may not be made as it may not be just and equitable not to make one. Alternatively, it may be just and equitable to make an order which differs from the order which might have been made pre-*Stanford.*

Although the High Court did not appear to confine its views to the unusual factual circumstances of the case, the Family Law Courts and lawyers may argue to restrict its impact. Despite some uncertainties of interpretation, the High Court majority gave some clear directions as to dealing with applications under s 79. It is important to first set out the legal and equitable interests of the parties. This is an aspect of the judgment which is of particular importance for trustees. Then, it must be determined whether it is just and equitable to make an order altering those interests under s 79(2). In the absence of a definition of "just and equitable" it is open for trustees to argue that where a non-bankrupt spouse has received benefits from the debts of the bankrupt, it is just and equitable that they be paid. A non-bankrupt spouse may not be absolved of liability even if they did not know of the debts and could not be expected to have known.

There may be a greater focus on balancing the possibility of leaving existing interests as they stand and making declarations under s 78 that the interests exist, rather than altering the interests under s 79. The High Court might be saying that the Family Law Courts and legal practitioners have only been paying lip service to the just and equitable requirement of s 79(2) by merely considering it in passing after considering s 79(4) at length. It may be given greater weight in the future. The fate of the "four step" approach is unclear.

In any event, the High Court emphasised that the principles set out in the Act must be carefully followed. It is insufficient to simplistically summarise s 79 without referring to the actual words used in the Act.

There are opportunities arising from *Stanford* for trustees to achieve better outcomes in the Family Law Courts than they generally have in the past. It is too early to say whether these increased opportunities will lead to increased successes.

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