FAMILY LAW
AND
BANKRUPTCY

With a sprinkling of Joint Tenancy

DISCUSSION GROUP

7 December 2016

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Note - In most seminar papers in this area the spouse who is not bankrupt is referred to by the cumbersome term "non-bankrupt spouse". In these notes:
"wife" means "non-bankrupt spouse"
BA = Bankruptcy Act
FLA = Family Law Act

Simplified family law property settlement observations:

1. Wide discretion – s79(1) FLA allows Family Court to adjust property according to what is just and equitable.

2. Where there is no bankruptcy, the net asset pool is overall assets of both spouses less their overall liabilities. Family Court then splits the net assets pool. Where there is a bankruptcy, Family Court can make orders in favour of the wife even though the combined liabilities exceed total value of the property (including property vested in the bankruptcy trustee) – *Trustee of the Property of Lemnos & Lemnos* [2009] FamCAFC 20.

3. If asset pool is very small (< $100,000) then wife likely to get high percentage (could be 95% or more).

4. If high value asset pool then more likely to be 50/50. If 50% is $3 million then wife can probably live comfortably without needing any further adjustment in her favour.

1 Year Before Bankruptcy of Husband

WIFE

Half Share Family Home (in joint names)	$600,000
LESS Half Share Mortgage	$100,000
Net Assets	$500,000

HUSBAND

Half Share Family Home	$600,000
LESS Half Share Mortgage	$100,000
House equity	$500,000
Superannuation	$200,000
Business Debts (Sole Trader)	$900,000
Net Assets (including superannuation)	-$200,000

DIFFERENT SCENARIOS

1. Husband goes bankrupt on those figures with no family law issues.

2. Husband gifts his half of house to Wife (say 9 months before bankruptcy).

3. Family Court consent orders made transferring house to Wife (say 9 months before bankruptcy).

4. Wife starts Family Court proceedings after bankruptcy claiming whole house.

5. Wife starts Family Court proceedings before bankruptcy claiming whole house, ie proceedings on foot at date of bankruptcy.

SCENARIO 1 -

Husband goes bankrupt on those figures with no family law issues

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Superannuation does not vest in the bankruptcy trustee and remains with bankrupt, i.e. bankrupt keeps $200,000 superannuation.

Trustee gets half of house worth $600,000 less half mortgage $100,000 so bankrupt estate gets $500,000.

Wife also gets $500,000.

SCENARIO 2 -

Husband gifts his half share of house to Wife (say 9 months before bankruptcy)

Section 120 BA provides that a transfer of property by a person who subsequently becomes bankrupt in the period leading up to bankruptcy for less than market value consideration is void against the bankruptcy trustee. However, the bankruptcy trustee must refund the value of the consideration paid – s120(4). The period is either 2, 4 or 5 years depending on whether the bankrupt was solvent at the time and whether the transfer is to a related party.

The gift by the bankrupt nine months before bankruptcy of his half interest in the family home worth a net $500,000 is clearly void under s120 as there has been no consideration. Section 120(5)(d) says that "love or affection" has no value as consideration.

An argument often made in such situations by lawyers for the wife is that there was consideration in the form of an informal matrimonial separation agreement. In other words, the argument is that the husband transferred his half share of the family home to the wife at a time when they were experiencing marital difficulties in order to resolve the property issues between them, without the agreement having been formalised by way of Family Court consent orders or otherwise. Such an argument was rejected by the Full Court of the Federal Court in *Official Trustee in Bankruptcy -v- Lopatinsky* [2003] FCAFC 109 (paras 105-109).

In short, the Court found that it was not possible for the wife, by entering into an informal agreement with her husband, to preclude herself from applying to the Family Court for an order for property adjustment. Even if there was an implied promise by the Wife not to seek property settlement in the Family Court, it still remained open to her to make a property settlement application in that Court i.e. to apply for more than what she had received under the informal agreement. Accordingly, the Court held that any promise given by the wife under an informal agreement had no commercial value i.e. a nil market value consideration for the purposes of s120 BA.

Another important point to note about s120 is that a transfer for less than market value consideration will be void unless full market value consideration has been paid i.e. the transfer is void even if only one dollar less than market value consideration has been paid. If

the bankrupt has transferred a $50 asset to his wife and received a payment of $49 from her, then the transaction is void under s120. At first glance, this appears to be an academic exercise as the trustee would recover a $50 asset but would then have to refund the consideration of $49 to the wife resulting in a $1 recovery.

However, the effect of a transaction being void under section 120 is that if the recipient still has the asset, then the recipient holds the asset on trust for the bankruptcy trustee as from the date of bankruptcy (*Anscor Pty Ltd v Clout (Trustee)* [2004] FCAFC 71, and in particular the judgment of Lindgren J (with whom Wilcox and Moore JJ agreed) at paragraphs 43(i) and (j) and 125-135). The effect of this is that if the property is still held by the recipient then the bankruptcy trustee can claim the present value of the property rather than only the value of the property at the time of the transfer. In other words, if the $50 asset transferred for $49 is now worth $100, then the bankruptcy trustee can recover $100 instead of $50 while still having to refund the consideration of $49, ie there is a $51 recovery as opposed to only a $1 recovery.

Also, under s121 trustee can set aside transfer where intent to defeat creditors (no intent required under s120). Benefit of s121 is no time limit. In *Trustees of the Property of Cummins v Cummins* [2006] HCA6 trustees succeeded under s121 where:

1. Transfer 13 years before bankruptcy;
2. Debtor only had "contingent" tax debts at date of transfer.

SCENARIO 3 -

Family Court consent orders made transferring house to Wife (say 9 months before bankruptcy)

In general, the closer the consent orders are to the date of bankruptcy, the more suspicious the circumstances.

Under this scenario, the Husband and Wife jointly file an application with the Family Court for consent orders. In that application, they are required to set out their assets and liabilities. The application is assessed by a magistrate of the Family Court without any court hearing taking place. In the vast majority of cases, the Family Court will simply make the orders sought (but may decline if it is obvious that a clearly insolvent person is disposing of assets). Consent orders are made under s79 FLA which gives the Family Court a wide discretion to adjust property between spouses.

On the figures provided, the effect of consent orders transferring the bankrupt's half of the house to the Wife is that she ends up with a house property worth $1.2 million with a mortgage of $200,000 being an equity of $1 million. The Husband retains his superannuation of $200,000 which is not available to his creditors in the bankruptcy. He also retains his business debts of $900,000 which subsequently pass into his bankrupt estate. There are no assets vesting in the bankruptcy trustee. In effect, the husband has divested himself of his interest in the house and received nothing in return.

At first glance, this appears to be a transfer which is void against the bankruptcy trustee under s120 BA as the Wife has given no consideration for the transfer of the Husband's half interest in the house to her.

However, the Full Court of the Federal Court in *Official Trustee -v- Mateo* (2003) 202 ALR 571 held that sections 120 and 121 BA do <u>not</u> apply where there has been a transfer under a Family Court consent order. Those sections only apply where there has been "a transfer of property by a person" who subsequently becomes bankrupt. Where the transfer is pursuant to a Family Court consent order, the transfer is by the Court and not by the bankrupt. This is because the Family Court has a discretion not to make the consent orders even if both parties

are asking the Court to make orders agreed between them. If the Family Court decline make the orders then there is no transfer.

The only avenue available to the bankruptcy trustee in this situation is to make an application to the Family Court under s79A FLA to set aside the consent order which has been made under s79. To succeed under s79A, the bankruptcy trustee needs to show that there has been a miscarriage of justice by reason of fraud, duress, suppression of evidence (including failing to disclose relevant information), false evidence or other relevant circumstances. The bankruptcy trustee therefore has a more difficult task under s79A than simply showing less than market value consideration under s120 BA.

In seeking to run a s79A case, matters to look for would include:

1. A failure by the bankrupt to disclose all of his actual or contingent debts to the Family Court in the application for consent orders.

2. Whether the parties are genuinely separated, eg Statement of Affairs may show both still at same address. Can have separation under one roof.

The Official Trustee brought a successful s79A application in *Official Trustee in Bankruptcy & B and G (deceased)* [2005] FamCA 1163. An outline of the case is as follows:

1. Consent orders were made under s79 FLA by a Registrar in Chambers on 20 July 1992 which provided for the husband to transfer to the wife his interest in a property subject to the existing mortgage. Other orders were made in relation to furniture, motor vehicles, another property, superannuation and various other matters.

2. The Official Trustee's application under s79A was filed on 5 November 2003 seeking orders that the consent orders be set aside due to suppression of evidence causing a miscarriage of justice. The aim was to restore the Official Trustee and the wife (or her deceased estate by that stage) to joint ownership subject to a $10,000 mortgage liability.

3. The application for consent orders failed to disclose judgment debts owed by the husband to a creditor and also to his former solicitors. These judgment debts were for $34,464 and $26,044.

4. The judge found that the judgment debts "were known and should have been fully disclosed. I find that their omission from the Financial Statement and the agreed Statement of Facts were both intentional and deliberate and that there was a suppression of evidence and a failure to disclose relevant financial information."

5. The judge then moved to the discretion to vary or set aside the consent orders or to make another s79 order in substitution.

6. One of the factors considered by the judge was the lengthy delay by the Official Trustee in commencing proceedings. Nonetheless, the court exercised its discretion and set aside the paragraph of the consent orders relating to the house property.

7. The judge then moved to the question of whether it was appropriate to make another order under s79 in substitution for the orders set aside. The judge was not prepared to make a substituted order with the result that the bankruptcy trustee and wife's deceased estate ended up as half owners of the house property subject to the mortgage.

SCENARIO 4 -

Wife starts Family Court proceedings <u>after</u> bankruptcy claiming whole house

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s79(1) FLA was amended in 2005 to enable the Family Court to make orders adjusting the interests of parties not only in property of the parties to the marriage but also in property vested in the bankruptcy trustee.

Unfortunately, s79 FLA is a one-way street. The wife can make a claim under s79 against property vested in the bankruptcy trustee but the bankruptcy trustee cannot make a s79 claim against property of the wife.

If the wife starts Family Court proceedings after the date of bankruptcy claiming the whole or most of the house, then the wife's application will usually name the bankruptcy trustee as a respondent to the application. Section 79(12) provides that if the bankruptcy trustee is a party to property settlement proceedings then, except with the leave of the Court, the bankrupt is not entitled to make a submission to the Court in relation to the vested property. The fact that the resolution of the dispute over the division of the matrimonial home is a matter between the bankruptcy trustee and the wife is a concept which some bankrupts have difficulty in accepting.

The bankrupt's involvement is limited to his non-divisible property, of which usually only superannuation is significant.

In many cases negotiations occur between the wife and the bankruptcy trustee resulting in a division of the house equity being agreed between them. In many cases the wife will be wanting to keep the house and to pay an agreed amount to the bankruptcy trustee for his/her share. From the wife's point of view this will need to be documented by way of family court consent orders or a family law binding financial agreement in order for the wife to obtain a stamp duty (now called transfer duty) exemption. If the bankrupt is uncooperative then this can be put into effect by way of partial property consent orders between the wife and the trustee in the Family Court. This will only be a partial property settlement as the non-divisible assets which remain with the bankrupt under the BA will not form part of the consent orders. However, the wife may have concerns that the bankrupt may try to seek property settlement against her at a later stage.

SCENARIO 5 -

Wife starts Family Court proceedings <u>before</u> bankruptcy claiming whole house (proceedings on foot at date of bankruptcy)

Under this scenario, Family Court proceedings are on foot between the husband and wife at the date of bankruptcy and not yet concluded. Upon bankruptcy, the divisible property of the Husband will vest in the bankruptcy trustee. This will usually have the effect of converting at least some of the orders being sought by the Wife in the proceedings to orders being sought against property which has become vested in the bankruptcy trustee.

This means that the bankruptcy trustee will need to be joined as a party to the proceedings as it is not appropriate for the Family Court to be making orders against vested bankruptcy property without the bankruptcy trustee having the right to be heard on the matter. The bankruptcy trustee can apply to the Family Court to be joined as a party but it will usually be agreed between the bankruptcy trustee and the Wife that the bankruptcy trustee should be joined by consent. Under s79(11) the Court must join the bankruptcy trustee as a party to the proceedings if there are property proceedings, a party is bankrupt, the bankruptcy trustee applies to be joined and the Court is satisfied that the interests of the bankrupt's creditors may be affected by the proceedings. In other words, there is unlikely to be any difficulty in having the bankruptcy trustee joined.

Once the trustee is joined, then the position is otherwise as per Scenario 4.

SCENARIO 6 (Scenarios 2 & 4 combined) -

Scenario 2 - Husband gifts his half share of house to Wife (say 9 months before bankruptcy)

Scenario 4 - Wife starts Family Court proceedings after bankruptcy claiming whole house

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1. 1 year before bankruptcy, house owned 50/50.

2. 9 months before bankruptcy, husband gifted his 50% to wife, so that wife becomes 100% owner.

3. At date of bankruptcy, wife remains 100% owner.

4. Trustee makes s120 claim and restores 50/50 ownership (Scenario 2).

5. Wife then makes claim under s79 FLA and may end up with say 65% of house (Scenario 4).

Note that the Wife is the 100% owner of the house property at the date of bankruptcy. This means that there is no need for her to make any court application (but she may do so to put matters beyond doubt). The onus is on the trustee to pursue a s120 claim to restore 50/50 ownership. If the trustee's s120 claim is unsuccessful, then the Wife remains the 100% owner and there would be no reason for the Wife to make a claim under s79 FLA in relation to the house. If the Wife has a genuine dispute with the trustee's s120 claim, then she could contest that claim with the trustee having to pursue that application in the Federal Circuit Court or Federal Court. The Wife could await the outcome of those proceedings before deciding whether to pursue a claim in the Family Court. Alternatively, the trustee may be able to persuade the Wife to commence proceedings in the Family Court at the outset so that both the trustee's claim under s120 BA and the Wife's claim under s79 FLA can be dealt with in the same proceedings to save costs.

SUGGESTED FRAMEWORK

NORMAL BANKRUPTCY WITH NO FAMILY LAW ISSUES

Trustee will claim:

1. Divisible property of bankrupt (which includes any equitable interests the bankrupt has)
2. Void transactions
3. *Income Contributions*

Equitable interests are complex and imprecise. The legal title is the person named on the title. An equitable interest is the real underlying ownership behind the legal title (which can be the same or different). In very general terms, they arise where someone claims an interest in property (either entire property or a part share) registered in the name of someone else. This is usually where they have contributed money towards the property being acquired by the title holder and it would be unconscionable for the title holder to get the whole property.

The most famous equitable interest case in the area of bankruptcy and the bankrupt's spouse is the decision of the High Court of Australia in *The Trustees of the Property of Cummins, a bankrupt -v- Cummins* [2006] HCA 6. There were no Family Court proceedings on foot or even threatened involving the bankruptcy trustee. The bankrupt Mr Cummins was a QC, "a gentleman of the turf" and failed to lodge his income tax returns for about 45 years.

The bankrupt and his wife owned a property as joint tenants. The property was bought in 1970 and it was found that the wife had contributed 76% of the purchase monies. In 1987 the bankrupt transferred his interest in the property to his wife. At the time of transfer the property was valued at $410,500. The parties signed a contract and transfer of land showing the consideration to be one half of the valuation ($205,250) with the bankrupt signing an acknowledgment that he had received that consideration. However, the wife agreed in the court proceedings that she had not paid the purchase price or any part of it.

The bankruptcy trustees applied under s121 BA to set aside the transfer 13 years earlier of the bankrupt's interest in the house property to the wife. Section 121 applies where a transfer has taken place with intent to defeat creditors and there is no time limit. The Court found that the bankrupt had the main purpose required by s121 when he transferred his interest in the house to his wife as a substantial unquantified tax debt was accruing. This meant that the trustees were entitled to recover the wife's interest and restore the ownership to 50/50.

The wife then argued that the equitable interests in the property were 76.3% to her and 23.7% to the bankrupt based on their financial contributions towards the property. Accordingly, the effect of the transfer being void under s121, on her argument, was that the bankruptcy trustees would only be entitled to receive 23.7% of the proceeds of sale. The Court said that where spouses had each contributed towards the purchase price of the matrimonial home, then "it may be inferred" that it was intended that they would each acquire a one-half equitable interest in the property, regardless of the amounts contributed by them. The fact that the parties had taken the title as joint tenants rather than tenants in common was also a factor which counted against the wife. The Court also noted that the adoption by the parties of 50% of the valuation figure to set the purchase price stated in the contract and transfer indicated that the parties regarded themselves as equal equitable owners. Ultimately, the Court found that the bankrupt had a 50% equitable interest in the property at the time of transfer, even though he had only contributed 23.7% of the purchase money. This meant that the bankruptcy trustees could recover 50% under their s121 claim rather than only 23.7%.

Points to note about *Cummins*:

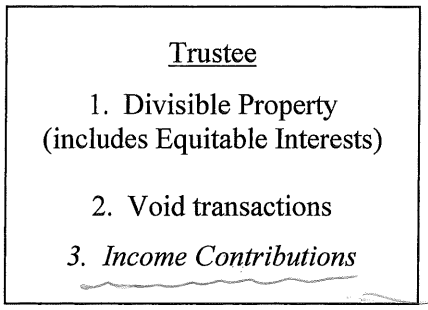
1. The equitable interest claim was <u>against</u> the bankruptcy trustees rather than by them (an equitable interest claim can also be made <u>by</u> the bankruptcy trustee);

2. The wife's equitable interest claim failed on the facts of the case.

IF BANKRUPTCY WITH A FAMILY LAW CLAIM:

Step 1 -

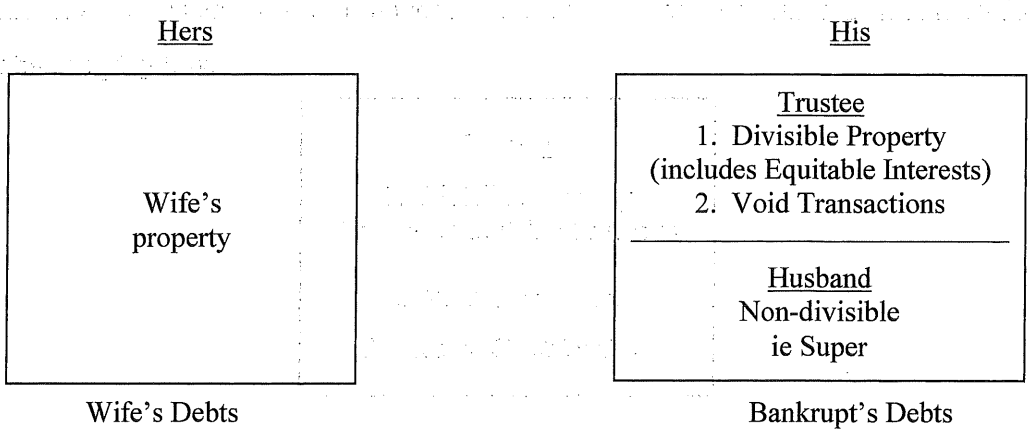
Leave aside Family Law (even if there are Family Court proceedings on foot or threatened) and ask what is trustee's position under normal bankruptcy, ie what is available to the trustee under bankruptcy law.



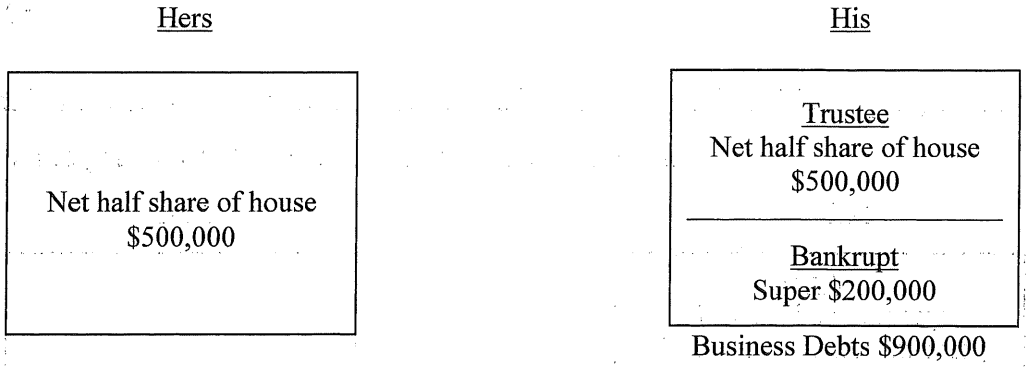
Note: Income contributions not relevant for present purposes as we are dealing with property.

Step 2 -

If Family Law claim arises, add in property of wife and non-divisible property retained by the bankrupt to get the whole picture in terms of His and Hers.



On our hypothetical figures, this would look as follows:



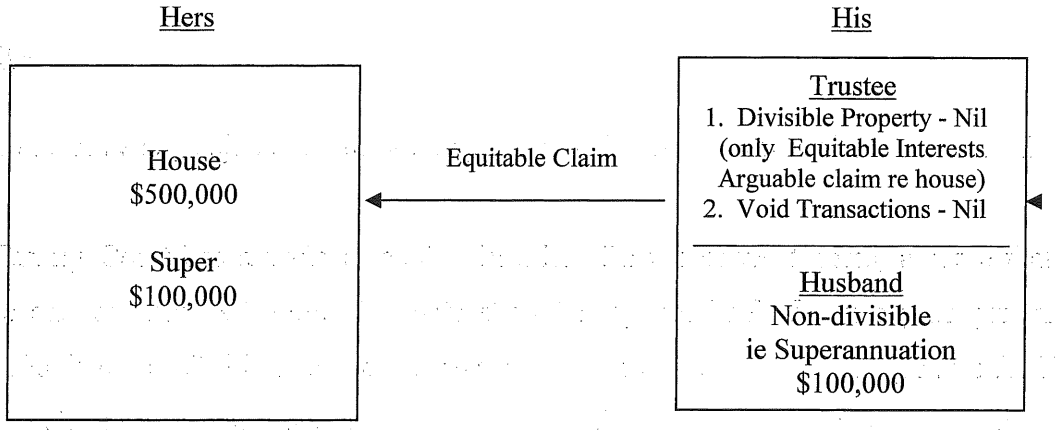
Step 3 -

Should there be any adjustment of property interests in favour of the wife under s79 FLA *Act*?

The Family Court has a wide discretion in this. On the above figures, assume that wife, trustee and bankrupt all agree that wife should keep her half of house plus get an extra $200,000 from "His" side to achieve a reasonable Family Law settlement (or that the Family Court decides this). The issue is then whether the $200,000 should come from the trustee's share of the house or the bankrupt's superannuation. This is a matter for negotiation or the discretion of the Family Court.

Example:

$500,000 unencumbered family home registered in wife's name:



1. Wife already has house - no need for her to make s79 claim. Trustee has to make a claim.

2. Trustee has no assets except for equitable claim against wife's house (largely paid for by bankrupt). Best case scenario 50% equitable interest, but Family Court could then adjust in wife's favour under s79 FLA.

3. Wife denies trustee's claim but prepared to pay an amount (possibly from her super if she is of retirement age) to trustee to settle trustee's claim.

4. Bankrupt (if of retirement age) might be prepared to pay an amount from his super to the trustee to enable wife to keep house.

Two Family Court cases

1. *Witt & Witt* [2007] FMCA fam 681

The matrimonial home was held in joint names and the bankrupt's half share vested in his bankruptcy trustees. The wife obtained orders from the Family Court requiring the bankruptcy trustees to transfer their half share of the house to her. In addition, the wife obtained an order that 95% of the husband's superannuation be transferred to her.

The Court took into account the fact that the house had a relatively low value and had a mortgage owing, and the fact that the wife was looking after three of the children. The husband's only unsecured debt was one for about $8,000 on which he was made bankrupt. The Court was critical of the fact that the bankruptcy trustees had incurred some $25,000 in legal fees as well as some $17,000 for their own remuneration and disbursements as against the relatively small amount of creditor claims in the bankrupt estate. The judge held that the trustees' costs should be disregarded in arriving at the apportionment of assets between the parties.

The concern for bankruptcy trustees arising from this case is that a trustee can take on an appointment in good faith relying on the fact that there is an asset in the form of a half share in a house property available to meet the trustee's fees. At a later stage the Family Court can order that the entire asset be transferred to the wife, leaving the trustee with no means of recovering fees.

2. *Debrossard v Official Trustee in Bankruptcy* [2011] FamCA 648

Husband became bankrupt on 12 April 2007. On 7 December 2007 (after date of bankruptcy) husband and wife obtained consent orders in the Family Court. Effect of orders was for husband to transfer his half interest in the former matrimonial home to the wife. Official Trustee was not given notice of the application. The court set aside the consent orders under s79A FLA as the husband's property was already vested in the Official Trustee and the husband had no property upon which the orders could operate.

The court then considered an appropriate family law property adjustment and agreed with the Official Trustee's proposal that the available equity in the former matrimonial home (about $230,000) be split 60/40 in favour of the wife. This resulted in a dividend of about 33 cents in the dollar for creditors in the bankrupt estate.

Joint Tenancy issue

Question

A and B own a property as joint tenants. A has signed a number of personal guarantees that contained a charging clause and some of the creditors have lodged caveats to protect their interests. A dies (*of a heart attack caused by a surge of adrenaline when he saw his favourite contestant overcook the béchamel sauce during the Masterchef grand final*). What happens to those caveats given the joint tenancy? Does it matter whether B did or did not know that the charges were being given?

Answer

The Land Titles Registration Practice Manual (Version 14.0 (19 May 2016)) published by Landgate states at 2.6.5 that a joint tenant can mortgage his or her interest in land. It must follow that a joint tenant can also charge his or her interest. 2.6.5 goes on to state:

> "The mortgagee's interest in the land may die with the mortgagor should the mortgagor fail to survive the other joint tenant, but this is not certain (see Francis – Mortgages and Securities 2nd edition (1975) pages 56 and 57 and Lyons v Lyons (1967) VR 169)".

The above 1967 Victorian case of Lyons seems to be the only case on this point. In that case the judge said:

> "It follows that the rights of Mrs Gray, as mortgagee, against the land ceased upon the death of her mortgagor William Patrick Lyons. Consequently, registration of that mortgage after the death of William Patrick Lyons could serve no useful purpose and I think the Registrar of Titles would have been justified in refusing to register it at the date when it was lodged for registration".

It would make no difference whether the surviving joint tenant did or did not know that the charges were being given.