

Introduction – The 2005 Amendments Affecting Family Law Bankruptcy Cases

1. In September 2005 in a paper delivered at the Family Law Residential 2005 “Recent Cases & Emerging Law & Principles” Tim North SC considered the effect of the 2005 amendments to the Bankruptcy and Family Law Legislation Amendment Act 2005 and the Family Law Amendment Act 2005 and said as follows:-

“In the Attorney General’s explanatory memorandum accompanying the Bill, the following appears under the heading “Interaction between Family Law and Bankruptcy”:-

- “9. There are a number of difficulties which can arise when bankruptcy and family law issues and/or proceedings exist at the same time. There are inconsistencies between family law and bankruptcy law which create uncertainty for all involved and can cause hardship for either or both creditors and non-bankrupt spouses;*
- 10. From a bankruptcy perspective, trustees can find themselves in an uncertain position when having to resolve or reconcile competing claims. Creditors unaware of the potential property interest of a non-bankrupt spouse also suffer from a lack of certainty.*
- 11. From a family law perspective, the legal ownership of property does not always reflect the non-financial contribution of a parties to the marriage. The special interest of the non-bankrupt spouse in the marital property created through both financial and non-financial contributions, which may be recognised by the Family Court in exercising its discretion to alter property interests, is not expressly recognised under the Act.*
- 12. Different outcomes result depending upon the order in which events occur (those events including separation, bankruptcy and distribution of property by the trustee in bankruptcy).*
- 13. The amendments proposed in the Bill will address these issues by clarifying the rights of the bankruptcy trustee and the non-bankrupt spouse. Generally, the amendments will enable currently bankruptcy and family law proceedings to be brought together to ensure all the issues are dealt with at the time.”*

1. *Without wishing to sound harsh, it is my view that as an exercise in clarifying the rights of the bankruptcy trustee and the non-bankrupt spouse the amendments brought about by this Act are not obviously successful. The amendments clarify where those competing claims are now to be resolved but offer little guidance to the court or those practising within it as to how those competing claims are to be resolved. Paragraph 11 of the explanatory memorandum is curious. It refers to interests in “marital property” which interests are created through contributions but is silent as to the interests that might arise by reason of other matters to which the Act requires a court to direct its attention, including those matters under subsection 75(2) of the Act.*

2. *Perhaps the true position is that the legislature intended that the only significant change to the law, at least with respect to property settlement, was to enable the Family Court to have regard to debts and in particular unsecured or contingent debts of a party to the marriage after a bankruptcy in much the same way as the court has to date dealt with such liabilities where there has been no bankruptcy. Perhaps it is the case that courts will ultimately deal with property settlement in the context of bankruptcy and the claims that now can be made by the non-bankrupt spouse against vested bankruptcy property by an adaption of the principles espoused by Evatt CJ in Prince v. Prince (1994) FLC 91 501 at 79,076 – 79,077 where her Honour the Chief Justice said: -*

“The assessment of debts and liabilities is not necessarily arrived at by a strictly mathematical or accountancy approach in all cases. While some liabilities are charges upon the property which can be accurately assessed at a certain date, others are at large, or have not been precisely determined, (eg tax liabilities Kelly v. Kelly No. 2 (1991) FLC 91-108 p. 76,801 and) in some cases the amount of the liability can only be estimated generally (Alban (supra) p. 75,717). The Court can make allowance for a particularly liability if appropriate to do so. In some cases there are sufficient uncertainties as to the alleged liability to lead the court to disregard it entirely or partly (eg a loan from a parent of a party not likely to be enforced; Af Petersons, supra); Quirk (1983) unreported). In other cases, the Court may take the view that because of the circumstances surrounding the incurring of the liability it ought in justice and equity to be wholly or partly disregarded in determining the appropriate order to make under Sec79 as between the parties to the marriage. Such a result could be reached where a spouse had

incurred a liability in deliberate or reckless disregard of the other party's potential entitlement under Sec79 (Kimber v. Kimber (1981) FLC 91-085; Kowaliw v. Kowaliw (1981) FLC 91-092; Antmann v. Antmann (1980) FLC 90-908; Af Petersons, supra). Complex issues can arise in regard to liabilities to third parties (see e.g. Pockran v. Crews; Pockran (1983) FLC 91-311).

Of course the Court cannot ignore the fact that there is or may be a liability; the effect is simply that it does not consider that the other spouse should be called upon to in effect "contribute" to the liability by having that spouse's fair share of the party's property reduced by virtue of its existence. The effect may be that the party who has incurred the liability will be left to meet it out of whatever funds remain to that party after satisfying the order made under Sec 79 (Af Peterson, supra)."

2. The pre-2005 position was neatly encapsulated by the Hon Justice TE Lindenmayer and Paul Doolan in their May 1993 article "When Bankruptcy and Family Law Collide" in which they said:-

"The problem...is that if the claim of the spouse is determined on the basis of the "usual practice", with the unsecured debts of the other spouse being deducted from the gross value of the assets in order to ascertain the "net property" available for division between the spouses, there will frequently be no "net property" in respect of which an order under sec 79 can be made in favour of the claimant spouse, resulting in a dismissal of his or her application. The whole of the debtor spouse's estate will thus remain available for division amongst his or her creditors upon insolvency, and those creditors able to prove their debts in the bankruptcy will effectively have gained a "priority" over the non-debtor spouse who, having failed to obtain any order (under) sec79, has no debt to prove.

3. In *Trustee of the Property of G Lemnos, a Bankrupt & Lemnos and Anor (2009) FLC 93-394* Coleman J noted that it was clear that Parliament intended by the 2005 amendments to change bankruptcy and family laws so as to avoid the situation where a non-bankrupt spouse could only make a s 79 claim against non vested bankruptcy property and whatever other property might remain after the completion of the bankruptcy. In his Honour's view "the preferred position of unsecured creditors of the bankrupt spouse" was removed by the 2005 amendments.

4. Section 35 of the Bankruptcy Act expressly provides to the Family Court jurisdiction in bankruptcy where:-

- (a) a party to the marriage is bankrupt; and
 - (b) the trustee in bankruptcy is a party to proceedings for (i) a property settlement; (ii) section 79A proceedings; (iii) an application for spouse maintenance.¹
5. As a result of the 2005 amendments to the Family Law Act the Family Court now has jurisdiction to make orders about three categories of property, namely (i) the vested bankruptcy property of the non-bankrupt spouse (ii) the exempt property of the non-bankrupt spouse; and (iii) the property of the non-bankrupt spouse.
6. “Vested bankruptcy property” means the property of the bankrupt, and the after-acquired property of the bankrupt that vests in the trustee by operation of ss 58, 59 and 59A Bankruptcy Act. The main categories of exempt property, per s116(2) Bankruptcy Act, are:-
- (a) property held by the bankrupt in trust for another person;
 - (b) the bankrupt’s household property;
 - (c) property used by the bankrupt in earning income by personal exertion;
 - (d) the bankrupt’s primary means of transport;
 - (e) the bankrupt’s policies of life insurance and superannuation; and
 - (f) certain rights of the bankrupt to recover damages.
7. The “property of the non-bankrupt spouse” in this context is that property which is neither vested bankruptcy property nor exempt property. It would include for example, that income earned during the bankruptcy or those assets accumulated during the bankruptcy which do not fall into the pool available for creditors.
8. Section 79 Family Law Act now enables the Court to make an order requiring the relevant bankruptcy trustee to make, for the benefit of either or both of the parties to the marriage or a child of the marriage, such settlement or transfer of property as the court determines: s 79(1)(d)(ii). This provision allows the Court to make an order against vested bankruptcy property. Section 75(2)(ha) FLA provides that a matter to be taken into account (when exercising the

¹ See Addendum 1

Court's s 79 jurisdiction) is the effect of any proposed order on the ability of a creditor of a party to recover the creditor's debt, so far as that effect is relevant.

9. Section 116(1) of the Bankruptcy Act sets out the property that is divisible amongst the creditors of the bankrupt. Section 116(2)(q) provides a specific exclusion for any property that, under an order under Part VIII of the Family Law Act 1975, the trustee is required to transfer to the spouse of the bankrupt.

Consideration of Case Law of the competing interests of Creditors and Non-Bankrupt Spouses

10. In *Trustee of the Property of G Lemnos, a Bankrupt & Lemnos*² the principal debt following the sequestration of the husband's estate was a liability for unpaid tax to the Australian Taxation Office exceeding \$5,700,000, arising from a re-assessment of income tax for the years 1991 to 2002. The principal asset of the parties was the home, held in the husband's sole name and in which his equity was about \$2,085,000.
11. The principal tax debt was of about \$3,400,000. It arose through the husband improperly claiming tax deductions for two properties – principally property W, acquired in 1989 for \$1,300,000, renovated and occupied by the parties from 1991. Property W was worth \$4,500,000 to \$5,000,000 at the time of the trial.
12. The trial judge made orders that the home vested in the bankruptcy trustee be sold and the net proceeds be divided equally between the trustee and the wife.
13. Coleman J considered the submission of the trustee in bankruptcy that the trial Judge erred in declining to find that the parties could never have acquired and/or retained the property owned by the husband, if the husband had properly completed his income tax returns between 1991 and 2002. His Honour said that while it was “superficially attractive” to assume that the wife's significant income was related to the husband's failure to lodge accurate tax returns and thereby have more income to pay through the family trust than would otherwise have been the case, and “reasonable to infer” that the wife and the family would have benefited from the husband's taxation indiscretions, it did not follow, and had not been established, that, had the wife not derived the significant income which she did in the way in which she did, the parties would have been unable to acquire and retain the property.

² (2009) FLC 93-394

14. Ultimately in *Lemnos* Coleman J found that the appellable error of the trial Judge lay in having decided prior to his consideration of s75(2)(ha) FLA, that it was “*appropriate in this case to require the husband to satisfy the debt to the ATO from his own resources*”. In his Honour Justice Coleman’s view, only after a consideration of s75(2)(ha) FLA could the trial Judge have permissibly reached that conclusion. In his Honour’s view, when the trial Judge considered that provision he had already decided the issue which it directed him to consider.
15. His Honour indicated the nature of the section 75(2) considerations he thought should have been dealt with, even if the wife had a “*prima facie entitlement to an adjustment pursuant to s75(2) FLA*”. They were:-
 - (a) whether such entitlement was outweighed by the quantum of the husband’s indebtedness;
 - (b) the identity of the creditor;
 - (c) the manner in which the indebtedness arose; and
 - (d) the reality that, on the evidence before him, the wife must have benefited, directly or indirectly, from the husband’s non-payment of, at least, his proper primary taxation obligations from 1991 to 2002.
16. Coleman J disagreed with a contention by Dr Tom Altobelli (now His Honour, Federal Magistrate Altobelli) that a legislative intention to prefer “*the needs of children and spouses*” over those of creditors could be inferred in the new provisions. His Honour however indicated that he agreed that in some cases in a proper exercise of discretion, unsecured creditors may be disadvantaged by comparison with a bankrupt’s children and spouse, and that in other cases the converse might occur.
17. His Honour also agreed with Dr Altobelli’s suggestion that many unsecured creditors could have protected themselves against the consequences of being unsecured, but that that was not so in *Lemnos*.
18. His Honour Justice Coleman’s comment concerning the creditor’s inability to protect itself may be read as a reference to the fact that there was no or no reasonable channel for the Australian Taxation Office to secure its debt during the period in which it developed. His Honour’s view is

consistent with that of the Full Court of the Family Court of Australia in *Commissioner of Taxation & Worsnop & Anor*³ in which their Honours said:-

“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.”

19. His Honour indicated that no statement of principle should be made in a vacuum; each case turned upon its own facts and circumstances; and that the findings in a particular case will potentially determine whether there is, or ought to be, property with respect to which an order could, or should, be made. The “reconciliation” of the conflicting rights of unsecured creditors of the bankrupt and the rights of the bankrupt’s spouse involves the exercise of discretion. That discretion is clearly exercised by reference to (a) the facts as found and (b) the relevant provisions of the FLA. The task according to his Honour is to balance the competing claims of unsecured creditors and the non-bankrupt spouse, in the exercise of the wide discretion now conferred upon the Court by s 79.
20. In their joint judgment their Honours Thackray and Ryan JJ stated that they agreed that the Court may make orders in favour of a non-bankrupt spouse, even though the combined liabilities exceed the total value of the property (including any property vested in the trustee).
21. Their Honours considered the trustee’s submissions that his Honour should have found that the husband would not have had the resources to acquire and renovate the property without the savings made as a consequence of his wrongful claims for tax deductions; that he should not have found that there were a number of possible outcomes for the husband which may not have meant the parties would not have been able to acquire and renovate the property; and that he should have found that the property would not have been able to be acquired, renovated, maintained and retained, had the husband not had funds available to him from savings generated by wrongful claims for tax deductions.

³ (2009) FLC 93-392

22. Their Honours indicated that to assess the merit of those grounds it would be necessary to determine “*the combined incomes of the husband and the wife and then compare the total with the payments required on the facilities associated with the property holdings, including the property*”. They noted that the trial Judge’s attention was drawn to the husband’s income for only one year. They rejected that they should draw inferences from facts said to show the husband’s parlous financial state at the time he acquired the property. They concluded that “*in the absence of detailed information concerning the extent of the husband’s gross income and the interest payable on the mortgage, we are unable to conclude that it would have been impossible for the husband to acquire, renovate and retain the property without the taxation relief*”.
23. Their Honours noted that the trial Judge had available all of the taxation returns and had concluded that “*there were a number of other possible outcomes*”. They noted also that although the trial Judge had declined to receive from the trustee a spreadsheet summarising the financial analysis that the trustee had been putting, there had been nothing preventing counsel for the trustee providing such an analysis to the Full Court.
24. However, although unpersuaded that the husband could never have retained the property without the benefit of the deductions, their Honours noted that it was not suggested that the deductions had not *assisted* the husband to do so. The trial Judge appeared to have given no consideration to the significance of the fact that the wife had enjoyed the benefits flowing from the income tax deductions. This was a necessary fact for the trial Judge to have considered. The wife’s lack of knowledge or complicity in the husband’s wrongful deductions was not determinative of whether she should ultimately share responsibility for the payment of primary taxation on income earned during the marriage.
25. Their Honours considered the manner in which the trial Judge considered the s75(2)(ha) considerations. The trial Judge had found that an adjustment in favour of the trustee was not warranted because it would work an injustice and hardship upon the wife in the circumstances of this particular case. Their Honours considered that given that his Honour’s orders would lead to unsecured creditors receiving only a very small proportion of their entitlement, it was incumbent upon the trial Judge to explain in what way any adjustment in favour of the trustee would cause the wife “*injustice and hardship*”.

26. In erring in his exercise of discretion his Honour had given “*disproportionate weight to the wife’s lack of complicity in the husband’s indiscretions*” and “*inadequate weight to the fact that the wife had benefited from those indiscretions*”.
27. In *Commissioner of Taxation & Worsnop & Anor (ibid)* the Full Court of the Family Court of Australia considered a case in which the only substantial asset of the parties was the parties’ home, worth \$4,750,000. The tax liability of the husband, including interest and penalties, exceeded \$12,000,000. The tax liability arose through the husband conducting business activities in a way “*which did not involve paying tax*”.
28. The parties commenced cohabitation in late 1991 or in 1992. Tax avoidance started in 1996. The wife made an application for property settlement in February 2006 and in the same month the husband made a voluntary disclosure to the Australian Taxation Office, which intervened in the property settlement proceedings.
29. The home had been purchased in joint names for \$3,450,000 in June 1999 (well after tax avoidance had started). In October 2000 the husband’s one half interest, then worth \$1,500,000, was transferred to the wife for \$1.00.
30. The wife’s taxation affairs were always in order. The trial Judge found that the wife did not know of the husband’s non-disclosure of income for tax purposes. Nor ought the wife have known of such non-disclosure. The wife had understood that the husband had issues with third party commercial creditors which had been a reason for the home to be transferred into her name – but as far as she was concerned the husband was very successful in his sole control of the business activities.
31. In considering s75(2) factors the trial Judge indicated that the weight which he was required to attribute to the indebtedness to the Australian Taxation Office led him to conclude that he would not make an adjustment to the wife. The effect of his analysis of contributions as 50/50 between the husband and the wife was therefore the ultimate outcome.
32. The Full Court dealt with the Commissioner’s argument that the trial Judge should have found that the source of funds for the acquisition of real estate, was monies upon which tax was unpaid. They found that the trial Judge had clearly “*had in mind*” the issue of the source of funds for the acquisition of real estate; and that the degree to which the source of funds for the purchase of

real estate was either unpaid tax, or at least income upon which tax should have been paid, was one as to which, *on the evidence*, no precise finding could be made. The evidence was that the husband and the wife directed gross funds to various ends. No-one could say whether the moneys that should have gone to the Commissioner of Taxation went specifically into real estate.

33. Given those facts the issue of the source of funds for the purchase of real estate was one that could adequately be dealt with by recognition of the “broad” facts relating to it, rather than “close analysis” of evidence relating to it.
34. The Full Court considered the relevance of knowledge by the non-debtor spouse, of the debtor spouse’s tax avoidance. Their Honours stated that knowledge was a factor relevant to the exercise of the trial Judge’s discretion. The question of innocence or ignorance in a spouse may be relevant whether to the issue of unpaid prime tax or penalties, even where the “innocent spouse” has received benefit from the failure to pay tax. It might be that “knowledge” would be almost irrelevant, where net assets, sufficient to meet reasonable claims under s79, remained after payment of any debt for prime tax, but “knowledge” might come into sharper focus where liabilities exceed assets.
35. The trial Judge explained that he had given “much weight” to the fact that the outstanding tax indebtedness of the husband was a debt to the Crown and that there was a public interest issue that so far as was reasonably possible to do given the terms of s79 and the wide discretionary power to make orders that were just and equitable, orders should be made that “*enable partial satisfaction of that indebtedness (out) of the only significant property of the parties*”. The wife had not been placed in a position in which she could make a choice (ie to not join in or tacitly participate in or accept the tax avoidance). He expressly took into account the wife’s unwitting receipt of benefits of a lifestyle enhanced by tax avoidance.
36. The Full Court found that the trial Judge balanced the “competing claims” by depriving the wife of an adjustment to which he saw her as otherwise entitled, on account of s75(2) factors, and of an adjustment for the notional asset represented by the husband’s paid legal costs, and of one-half of the monies in the controlled money account, and another property.
37. Referring to the Commissioner’s argument about the relevance of *Johnson and Johnson (1999)Fam CA 369* the Full Court noted that while in that case the Full Court found that the trial Judge’s discretion miscarried when he failed to provide for the wife to share in any penalties that

may be imposed by the taxation commissioner, there was no question in that case of the “propriety” of an innocent spouse receiving nothing, to be weighed against the claims of a creditor. In *Johnson* the parties’ assets totalled \$30,000,000 and the tax and penalties were \$9,000,000.

38. The Full Court offered a hint at how the Commissioner might have improved its position, by saying that had the focus before the trial Judge been more along the lines of “*identifying and calculating the monetary representation of “compelling reasons for an award to the wife”, there may have been “closer examination of the needs of the wife for basic housing and sufficient other capital to set up a modest standard of living for herself and the children”*”. The future support of the wife and the children might have been seen as properly coming from her earning capacity, the husband’s earning capacity and, if necessary social security. A decision that the wife receive no more than that may well have been open: but the parties *including the Commissioner* left the trial Judge to do what he could with the evidence before him.

Consideration in case law of creditors’ interests and of the position of the Trustee in Bankruptcy

39. In his prescient article “Bankruptcy and family law – at the crossroads” Matthew Broderick, Partner, Gadens Lawyers noted that while under section 79(4)FLA the Court must take into the effect of any proposed order on the ability of a creditor of a party to recover the creditor’s debt, there was no requirement for consideration of the direct impact upon the trustee in bankruptcy. What, he asked, if the trustee in bankruptcy has incurred significant costs and outlays in the bankruptcy, only to see a non-bankrupt spouse obtain property free of the trustee’s equitable lien? Whose interests would be paramount?
40. This very issue arose in *Pippos & Pippos & Anor (2008)*⁴. The wife commenced property settlement proceedings after the husband became bankrupt on his own petition, in circumstances in which largely he had incurred debts in the post-separation period.
41. The total asset pool was worth about \$189,137 of which equity in the former matrimonial home was the major part. The wife proposed that she receive the one half share of the home that had

⁴ (2008) Fam CA 542

vested in the trustee, in return for a payment of \$20,000. She would take on the mortgage. The trustee in bankruptcy proposed a 60/40 division of all net property pool in favour of the wife.

42. Soon after the marriage commenced the wife had received her entitlement from her previous marriage, in a net sum of about \$135,000. This was “by far and away” the most significant financial contribution made by either husband or wife during the marriage. Detailed analysis occurred of the use of these funds. Further analysis occurred of the wife’s substantive post-separation contributions. An appropriate division according to the trial Judge, on contributions was 65/35.
43. In the meantime, the trustee in bankruptcy had incurred costs of \$31,500. The provable debts of the husband totalled \$28,577. The trustee had conceded in the proceedings that the debts were incurred subsequent to the separation of the parties and ought not be debts that should be considered as a liability in determining the property pool. It follows that for the trustee to “break even” it would have to have been awarded at least \$60,077 of the available net property.
44. The trial Judge ordered that the wife pay to the trustee in bankruptcy, a sum of \$39,741 and that she receive the transfer of a one half interest in the home (and refinance the mortgage into her sole name). This sum was calculated upon the basis of the 65/35 contributions outcome and a further 5% awarded to the wife having regard to section 75(2) factors. The trial Judge indicated that he would have awarded 10%, but for the balancing of those factors which favoured the trustee pursuant to s75(2)(ha) and (n) and the regard which he must have to the husband’s creditors’ ability to recover their debts.
45. In considering s75(2)(ha) the trial Judge did an analysis of the return in each dollar to the husband’s creditors *after payment of the costs due to the trustee*, of both the outcome as sought by the wife and the outcome as sought by the trustee. Similar mathematical analysis occurred in the trial Judge’s consideration of s75(2)(n).
46. The trial Judge considered his obligations under s79(2) and found that he had an obligation to do justice and equity between the parties to the proceedings, namely the wife and the trustee. He noted that while it was necessary in the “journey” towards a result in property settlement proceedings between the wife and the trustee to consider relevant matters which emerged from the marriage relationship, the rights of the husband’s creditors and considerations which must apply to the husband’s creditors represented by the trustee meant that ultimately the orders he

made on the issue of property settlement were as between the wife and the trustee and hence it was to them that the justice and equity of his orders had to apply.

47. The trial Judge indicated that the outcome he ordered recognised the significant contributions made during the marriage and the s75(2) factors which favoured the wife, but also “*the entitlement of the creditors to recover a proportion of their debts*”. After deduction of the trustees costs of \$31,500 the creditors would be recovering only an amount of \$8,241 of the total due to them of \$28,577, or a return of 29 cents in the dollar.
48. His Honour indicated that although the husband’s debts were incurred post-separation and the wife was in no way responsible for any of the debt, the consequences for her due to s75(2)(ha) and (n) were that she would be in part sharing responsibility for that debt. That was a just and equitable outcome between her and the trustee, which was further assured by giving the wife 90 days to pay the judgment sum.
49. The judgment therefore involved a recognition of the trustee’s costs, although it is arguable whether the quantum of the trustee’s costs was actively considered in forming the trial Judge’s view as to the appropriate exercise of discretion.
50. A similar issue arose in *Witt v Witt & Anor*⁵ with a significantly different result for the trustee. The parties had had a long marriage of which seven children were born. The husband became a bankrupt following a failure to pay a judgment debt of about \$10,000. The net pool of the parties including superannuation was \$146,012.
51. The trustee in bankruptcy had incurred costs totalling over \$60,000.
52. The trustee sought that the parties’ home be sold and that the net proceeds be paid 50/50 between the wife and the trustee. The wife sought about 95% of the non-superannuation assets and 95% of the husband’s superannuation, as well as all of her own superannuation.
53. The husband did not greatly assist the trustee, in that he simply declined to participate in the proceedings. The trial Judge his Honour Federal Magistrate O’Sullivan noted that in the absence of the husband’s participation in the proceedings the court’s findings would in large part be based on the wife’s evidence.

⁵ (2007) Fam LR 431

54. His Honour examined the circumstances in which the judgment debt arose and found that the husband's conduct in large part brought about the circumstance where the debt arose, the bankruptcy occurred and the husband's share in the parties' home vested in the trustees.
55. His Honour considered the trustees' legal and other costs. He acknowledged that the court was required to consider the interests of the creditors of the bankrupt spouse. He acknowledged that the costs of the trustees have priority by virtue of the relevant provisions of the Bankruptcy Act, but said that "*a more difficult matter arises where... the costs of the trustees... far exceed the debt due to the creditors.*"
56. His Honour noted that the trustees' costs were over five times the amount of the judgment debt. The effect of paying the legal and other costs of the trustees from the pool, would have been to reduce the net pool by almost 25%. His Honour did not believe it appropriate to include those costs. The Court was not pointed to authority that required the interests of the trustees by way of recovery of their remuneration and other costs to be taken into account, only the interests of the creditors.
57. His Honour accepted the submissions of the wife that the trustees had determined to become party to the proceedings to pursue an \$8,000 debt, all the way to final hearing; and done so with open eyes as to the possible costs consequences, "*as do all parties to Family Law proceedings which have as their starting point the principle that each party bear his or her own costs.*"
58. Consideration of contributions led to an 85/15 split in the wife's favour.
59. In his consideration of s75(2) factors his Honour considered the interests of the creditors, as required by s75(2)(ha). His Honour noted that the trustees had, "*presumably consistent with their duty*", acted to protect the interests of the creditors (His Honour referred to the decision in *Official Trustee in Bankruptcy v Bryan and Gatenby (deceased); sub nom Official Trustee in Bankruptcy v B and G (deceased) (2006) FLC 93-258* in which Young J noted that the primary obligation of the trustee to recover a sum sufficient to pay out creditors). However, what was required was to balance the interests of the creditors against the interests of the other parties to the proceedings and in particular, the wife.
60. In balancing those interests his Honour considered the wife's wish to maintain the home for the care of the children and the husband's position of leaving the wife to "pick up the pieces". He

agreed with the submission of the wife that given provisions in ss108 and 109 of the Bankruptcy Act 1966, it would be “perverse” if the wife and children were forced from their home and if the operation of the relevant provisions of the legislation in relation to the trustees’ costs meant that the actual creditor remained out of pocket.

61. His Honour also noted that while the trustees had submitted that the home was the only means available for the creditors’ debt to be met, there was *no evidence of attempts to reach agreements with the husband to pay the debt in other ways or to consider the proposal... by the wife to cover the...debt by accessing a payment from superannuation on the grounds of hardship.*
62. His Honour accepted the submission of the wife that an adjustment of 10% to her was appropriate.
63. In considering s79(2) and the just and equitable requirement, his Honour reiterated that the trustees had chosen to pursue the home. They had made “an economic decision” which had seen the costs, for a debt of around \$10,000, amount to more than \$60,000 and counting. His Honour concluded that it would not be just and equitable to make orders that would see the wife and the children removed from the home in order to meet what is in large part the trustee’s costs.

Summary of relevant considerations from case law involving trustees in bankruptcy and non-bankrupt spouses

64. The “reconciliation” of the conflicting rights of unsecured creditors of the bankrupt and the rights of the bankrupt’s spouse involves the exercise of discretion. That discretion is clearly exercised by reference to (a) the facts as found and (b) the relevant provisions of the FLA: per Coleman J in *Lemnos*.
65. In any exercise of discretion in family law matters, weight given to relevant matters is critical and generally requires proper explanation.
66. The Court may make orders in favour of a non-bankrupt spouse, even though the combined liabilities exceed the total value of the property (including any property vested in the trustee): per O’Ryan and Thackray JJ in *Lemnos*.

67. The analysis of contributions in these cases occurs in the orthodox way: see for example Rose J in *Worsnop* finding that on a “global” basis the financial and non-financial contributions of each of the husband and wife including in the role of homemaker and parent, were assessed as equal.
68. Trustees’ attempts to establish, that, had parties not derived the quantum of income which they did in the way in which they did (eg with the assistance of tax evasion or of avoidance of meeting other creditors’ terms) the parties would have been unable to acquire and retain the property, may be problematic. It may be easier and sufficient to assert and prove that the tax avoidance or avoidance of obligations to creditors assisted the parties to live a certain lifestyle and to create a certain asset pool.
69. See for example, *Worsnop* in which the Full Court found that the degree to which the source of funds for the purchase of real estate was either unpaid tax, or at least income upon which tax should have been paid, was one as to which, *on the evidence*, no precise finding could be made. The husband and the wife directed gross funds to various ends. No-one could say whether the moneys that should have gone to the Commissioner of Taxation went specifically into real estate.
70. If, on the other hand in a given case it appears possible to prove that the parties could not have derived the income or the property that they did without undertaking the avoidance of debts or obligations that they did, guidance can be found in the judgment of O’Ryan and Thackray JJ in *Lemnos*: it may be necessary, for example, to determine “*the combined incomes of the husband and the wife and then compare the total with the payments required on the facilities associated with the property holdings, including the property*”.
71. Consideration should be given to the significance of the fact that the non-bankrupt spouse has enjoyed the benefits flowing from avoidance of debt or tax obligations: per O’Ryan and Thackray J in *Lemnos*.
72. In considering sec75(2) factors and particularly sec75(2)(ha), relevant considerations include those of the kinds identified by Coleman J in *Lemnos*:-
- (e) whether what might otherwise be a reasonable entitlement of the non-bankrupt spouse based on a consideration of sec75(2) factors, is outweighed by the quantum of the bankrupt party’s indebtedness;
 - (f) the identity of the creditor;

- (g) the manner in which the indebtedness arose; and
 - (h) the fact that the non-bankrupt spouse has benefited, directly or indirectly, from the bankrupt spouse's non-payment of debts or obligations.
73. It is proper to have regard to the fact that orders sought will lead to unsecured creditors receiving only a very small proportion of their entitlement, when considering sec75(2)(ha). If "injustice" or "hardship" to the non-bankrupt spouse is being considered then the Court must consider also the position of the effect of the proposed orders on the creditors: per O'Ryan and Thackray JJ in *Lemnos*.
74. Dr Altobelli's suggestion that many unsecured creditors could have protected themselves against the consequences of being unsecured, with which His Honour Justice Coleman agreed with in *Lemnos*, may be a helpful consideration when considering the identity of the creditor and the circumstances in which indebtedness has arisen.
75. The Full Court appeared in *Worsnop* to indicate that in a bankruptcy matter it may be open to the Court in considering sec75(2) factors to identify and calculate "the monetary representation of compelling reasons for an award to the wife". This might involve, for example, "closer examination of the needs of the wife for basic housing and sufficient other capital to set up a modest standard of living for herself and the children".
76. It is respectfully suggested that if that approach is open, caution needs to be exercised that it does not override the orthodox 4 step approach in a way which causes the Court's discretion to miscarry. It has long been recognised that the sec79 exercise is not a "needs" based one.
77. The non-bankrupt spouse's lack of knowledge or complicity in the bankrupt spouse's avoidance of debts or tax is not determinative of whether she should ultimately share responsibility for the payment of primary taxation on income earned during the marriage: per O'Ryan and Thackray JJ in *Lemnos*.
78. However, knowledge of the debtor spouse's avoidance of debts or tax obligations is a factor relevant to the exercise of the trial Judge's discretion: per the Full Court in *Worsnop*.
79. "Knowledge" might come into sharper focus where liabilities exceed assets: per the Full Court in *Worsnop*.

80. In *Worsnop* the trial Judge's observation that the wife had not been placed in a position in which she could make a choice (ie to not join in or tacitly participate in or accept the tax avoidance), may be one of assistance to non-bankrupt spouses. The observation evokes the issue of "sexually transmitted debt", consideration of which may remain highly relevant in some family law bankruptcy cases.

A Closing Sentiment

Charles Dickens' father was detained in debtor prison. Informed by this matter, Dickens had Mr Macawber in *David Copperfield* reflect on this category of experience with some pith:-

"Annual income twenty pounds, annual expenditure nineteen pounds nineteen and six, result happiness. Annual income twenty pounds, annual expenditure twenty pounds ought and six, result misery."

I offer this in the uncertain hope that our clients and their spouses remain lucky enough to land on the right side of the ledger.

James Naughton – Director
RICE NAUGHTON BUCKLEY
james@rnblaw.com.au

18 October 2010

ADDENDUM 1

BANKRUPTCY ACT 1966 - SECT 35

Family Court's jurisdiction in bankruptcy where trustee is a party to property settlement or spousal maintenance proceedings etc.

(1) If, at a particular time:

(a) a party to a marriage is a [bankrupt](#); and

(b) [the trustee](#) of the [bankrupt](#)'s estate is:

(i) a party to [property settlement proceedings](#) in relation to either or both of the parties to the marriage; or

(ii) an applicant under [section 79A](#) of the [Family Law Act 1975](#) for the variation or setting aside of an order made under section 79 of that Act in [property settlement proceedings](#) in relation to either or both of the parties to the marriage; or

(iii) a party to [spousal maintenance proceedings](#) in relation to the maintenance of a party to the marriage;

then, at and after that time, [the Family Court](#) has jurisdiction in [bankruptcy](#) in relation to any matter connected with, or arising out of, the [bankruptcy](#) of the [bankrupt](#).

(1A) If, at a particular time:

(a) a party to a de facto relationship is a [bankrupt](#); and

(b) [the trustee](#) of the [bankrupt](#)'s estate is:

(i) a party to [property settlement proceedings](#) in relation to either or both of the parties to the de facto relationship; or

(ii) an applicant under section 90SN of the [Family Law Act 1975](#) for the variation or setting aside of an order made under section 90SM of that Act in [property settlement proceedings](#) in relation to either or both of the parties to the de facto relationship; or

(iii) a party to maintenance [proceedings](#) under Part VIIIAB of the [Family Law Act 1975](#) in relation to the maintenance of one of the parties to the de facto relationship;

then, at and after that time, [the Family Court](#) has jurisdiction in [bankruptcy](#) in relation to any matter connected with, or arising out of, the [bankruptcy](#) of the [bankrupt](#).

(2) Subsections (1) and (1A) do not limit [the Family Court](#)'s jurisdiction under [section 35A](#).

(3) In this section:

"*property settlement proceedings*" has the same meaning as in the [Family Law Act 1975](#) .

"*spousal maintenance proceedings*" means [proceedings](#) under the [Family Law Act 1975](#) with respect to the maintenance of a party to a marriage.

(4) An expression used in subsection (1A) that is also used in the [Family Law Act 1975](#) has the same meaning in that subsection as it has in that Act.