

Your Money or Your Wife

...or husband
...or significant other?

Bankruptcy and Family Law.



FEATURE ARTICLE

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In the June 2006 issue of the *Australian Insolvency Journal* we considered the impact of the recent *Cummins*¹ case. In that decision the High Court declared that there is presumption at law that all married couples own an equal share of the matrimonial property. This is regardless of whether the property is held in one or both of their names, and also regardless of the amounts contributed by each of them toward the purchase price.

The effect of the *Cummins* decision is that non-bankrupt spouses, who thought they had retained the whole property in their name, protected from the bankruptcy of their spouse, might lose 50 percent of the matrimonial property. What can they do about such an outcome? As we shall see, the only answer appears to be – separate from the bankrupt spouse.

Since the Full Federal Court decision in *Mateo*,² trustees in bankruptcy have been kept from utilising their powers under the *Bankruptcy Act 1966* to overturn or challenge Family Court orders. Rather, they must first go, cap-in-hand, to the Family Court, and ask for Family Court orders to be overturned. One is reminded of the poor, starving Oliver:

“Please, sir, I want some more.”³

Recent and proposed changes in Family Law and bankruptcy have increased this trend in favour of the Family Court in bankruptcy related matters. There is a clear preference on the part of Parliament for conflict issues between Family Law and bankruptcy.

However the developments have gone further than this in their effect and, arguably further than was intended. They have meant greater protection for non-bankrupt spouses who have separated from the bankrupt. They have also meant greater protection for the transfer of assets pursuant to Family Court orders.

One might be forgiven for concluding that the Government is determined to force married couples, faced with the bankruptcy of one of them, to separate, or bear the financial consequences if they stay together.

BFLLA Act 2005

The *Bankruptcy and Family Law Legislation Amendment Act 2005* (BFLAA) was given assent on 18 March 2005 and came into force, insofar as the interaction between Family Law and bankruptcy is concerned, on 18 September 2005.

In the most radical shake up between bankruptcy and Family Law in many years, the Federal Government has enacted legislation to allow non-bankrupt spouses to make or continue Family Law property settlement proceedings against their

bankrupt spouses. A trustee in bankruptcy is given the right (but not necessarily the funds) to appear in the Family Court, which is given jurisdiction to decide the non-bankrupt spouse’s application.

This is a significant departure to the previous law. Before the BFLAA, a non-bankrupt spouse who had separated from the bankrupt before commencement

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1. *The Trustees of the Property of John Daniel Cummins, A Bankrupt v Cummins* [2006] HCA 6.
2. *Official Trustee in Bankruptcy v Mateo* [2003] FCAFC 26 (28 February 2003).
3. *Oliver Twist*, Charles Dickens, 1838.

of the bankruptcy could have been left out of any distribution of the bankrupt's assets. The non-bankrupt spouse was left to participate in the same manner as all other creditors – that is, by reference to any debt or other equitable claim in the bankrupt estate.

The Government recognised that this could lead to hardship for non-bankrupt spouses and the children of the marriage or relationship. Accordingly, it put pen to paper and shifted the balance of power in favour of the non-bankrupt spouse by allowing the Family Court to determine a property application against the trustee in bankruptcy.

But hang on a minute. What if the non-bankrupt spouse does not wish to separate from the bankrupt? The answer is simple. The non-bankrupt spouse and the children of the marriage are unable to make any claim against the bankrupt estate.

Consider this example. Mrs Jones comes to see you in a state of distress. Her husband has just been declared bankrupt, having accumulated significant gambling debts without Mrs Jones' knowledge. All of the family's assets are in Mr Jones' name. What can she do?

If Mr and Mrs Jones remain together, the answer is: nothing. Mrs Jones and their four children miss out on any of the family's assets since Mrs Jones has not contributed to their purchase and has spent the last 20 years raising the couple's four children. She is not otherwise a creditor of Mr Jones and will not share in any distribution from the bankrupt estate.

On the other hand, if Mrs Jones tells you that she is thinking of leaving her husband, then your answer is radically different. You send her straight to family lawyers to make an urgent application against the trustee in bankruptcy, seeking spousal maintenance, on an interim basis, followed by a property application pursuant to the *Family Law Act 1975*. Having regard to her tireless efforts in support of the family, and her contributions to the marriage or relationship, together with the needs of her four children, Mrs Jones will almost certainly receive significantly more than 50 percent of the matrimonial property.

So what is the difference between these two scenarios? Four words: "I am leaving him."

Is this what the Government intended? What is to be the role of legal advisers called upon to advise Mrs Jones in the immediate aftermath of her

devastating news? Surely it would be remiss of such an adviser not to point out the obvious inconsistency between the two scenarios. At the very least such an adviser ought to ask the question, surely?

No doubt there is some merit in the argument that at least if Mr and Mrs Jones remain together, they have more chance of getting back on their feet financially. But is that really the point?

Now consider the matter from the perspective of the creditors of Mr Jones' bankrupt estate. Suddenly the trustee informs creditors that Mrs Jones is taking him to the Family Court in an effort to divest a significant portion of the bankrupt estate out of the reach of creditors.

How justified would creditors be in suspecting that this most recent matrimonial disharmony has more to do with preserving the family assets than in ensuring that Mrs Jones is able to survive? Would a disgruntled creditor be justified in engaging a private investigator to prove that Mr and Mrs Jones were in fact still happily married? There is an interesting thought: hiring private investigators to prove fidelity, and not the contrary!

This is an untenable situation. Such financial pressure ought not to be brought upon a married couple, particularly under the stress of the bankruptcy of one of them.

BLAA Act 2006

In the far less significant *Bankruptcy Legislation Amendment (Anti-Avoidance) Act 2006* (BLAAA), the Government's anti-marriage reforms can be seen in recent changes to the *Bankruptcy Act*.

It is only a minor point, but the message is the same. In amending s 121 of the *Bankruptcy Act*, the Government has attempted to make it clear that the grant by a non-bankrupt spouse to the bankrupt of a right to occupy the matrimonial home **is not** consideration for the purpose of the defences to that section.

So if a bankrupt transfers his half interest in his property to his wife in consideration for the right to live in the property for the next ten years, this will be insufficient to amount to consideration for the purposes of s 121. Accordingly, the trustee in bankruptcy may still seek to claw back this asset even though the transfer took place ten years ago, and the non-bankrupt spouse had no reason to suspect any ulterior motive for the transfer.

So what is unreasonable about this, you ask? The answer is: nothing at all. Such an arrangement between husband and wife would at the least seem to be unusual enough to warrant scrutiny under the *Bankruptcy Act*.

However, the change **does not** apply where the arrangement between husband and wife has been entered pursuant to orders made in the Family Court. So if Mr and Mrs Jones go down to the Family Court and register their arrangement as part of a property settlement, with consequential orders, then even though they remain living in the same property, this will be consideration such that the transfer may achieve protection against a claim by Mr Jones' trustee in bankruptcy.

Again, it is not necessarily whether or not such a transaction can be challenged that is of concern. Rather it is the distinction between the protection which is available to couples who have, or who are seen to have, separated and reached a property settlement under the provisions of the *Family Law Act*, with those couples who, in the face of financial distress of one of them, choose to remain together.

Superannuation and bankruptcy ⁴

The trifecta of anti-marriage developments is yet to come. In its consultation paper on reforms to the *Bankruptcy Act* to allow trustees to claw back excessive payments of superannuation, the Government had decided that in respect of both "excessive" superannuation contributions, and also those made with the intention of defeating creditors:

"A bankruptcy trustee would not be able to recover contributions from a superannuation interest that has been established for a spouse under the superannuation-splitting arrangements in the *Family Law Act* 1975."⁵

So notwithstanding its intention to defeat attempts by bankrupts to transfer funds into superannuation

in excess of what might be regarded as reasonable contributions (whatever that is ultimately determined to be), and even though such contributions are made with the intention of defeating creditors, the only people who will be protected in such circumstances are those that have binding Family Law superannuation-splitting arrangements.

Again, the message seems clear – asset protection is now an issue squarely within the Family Court. Trustees in bankruptcy and creditors prejudiced by such arrangements will need to persuade the Family Court to interfere with its own orders.

Conclusion

We saw in the June 2006 *Journal* from the decision in *Cummins* how it is not even possible to provide asset protection by placing the matrimonial property in the name of the non-bankrupt spouse.⁶

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We can see from the above amendments and proposals how parties who wish to obtain protection on bankruptcy, or access to assets, which would otherwise belong to the bankrupt's creditors, must now do so by separating from the bankrupt.

It is right for the Government to be concerned about those who, for various reasons, lose the financial support of their matrimonial partner and need to disentangle their financial affairs.

However, this must be balanced against the rights of unsecured creditors, and, perhaps more importantly, those non-bankrupt spouses who wish to remain and support their spouse as the family attempts to move beyond the effects of bankruptcy.

The Government has recently enacted legislation designed to preserve the sanctity of marriage between a man and a woman.⁷ It must also surely put its money where its mouth is, and support financially those who wish to maintain this marriage relationship. ■■■

4. The following section was written prior to the announcement by the Attorney-General on 27 July 2006 of its intention to replace the previous reform proposals referred to in the consultation paper discussed herein. The comments remain relevant to considerations of the Government's present inclinations regarding the treatment of those who have been separated, and because the revised reforms are yet to be seen.

5. "Effect of bankruptcy on superannuation contributions", Consultation Paper, September 2005, Attorney-General's Department at [14].

6. Without something more, indicating that this was the intention of the parties.

7. *Marriage Amendment Act 2004 (Cth)* According to the Explanatory Memorandum: "The purpose of the Marriage Amendment Bill 2004 ('the Bill') is to give effect to the Government's commitment to protect the institution of marriage by ensuring that marriage means a union of a man and a woman and that same sex relationships cannot be equated with marriage."