



NICHOLLES

Family Lawyers



Family law: implications in commercial law Presentation to Maddocks

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Introduction

This presentation will cover:

1. Recent High Court case *Spry v Kennon*:
 - setting aside commercial transactions under the *Family Law Act 1975*
 - when will family trusts form part of marital property to be divided under family law proceedings?
2. Bankruptcy and family law
 - implications of family law for bankrupts, non-bankrupt spouses and third party creditors

Kennon vs. Spry

Factual background

- In 1968, Dr Spry created by parol the ICF Spry Trust ('the family trust'), of which he was the settler and sole trustee. Dr Spry, his siblings, their spouses and their children were beneficiaries of the trust. In 1978, Dr Spry married Mrs Spry. Mrs Spry and the couple's four daughters were added as beneficiaries. In 1983 Dr Spry executed an instrument ('the 1983 deed') which removed himself as a beneficiary for land tax purposes, and appointed Mrs Spry as trustee upon his death or resignation.
- In 1998 the Sprys encountered problems with their marriage, and in December 1998 Dr Spry excluded himself and his wife as capital beneficiaries from the trust ('the 1998 Instrument'). He appointed the two eldest daughters as trustees upon his death or resignation instead of Mrs Spry. The Sprys subsequently separated in October 2001. On 18 January 2002, without informing the wife, Dr Spry set up four trusts for his daughters, and divided the income and capital of the trust equally between these (the 18 January 2002 disposition'). On 20 January 2002 he conveyed to his four daughters the shares held by him beneficially. During this period, Dr Spry also sold properties and shares held by either the trust or the couple, without Mrs Spry's knowledge or consent.



- In April 2002, Mrs Spry made application for property and maintenance orders in the Family Court under the *Family Law Act 1975* ('the Act').
- Mrs Spry successfully argued that the 1998 Instrument and the 2002 disposition should be set aside under s 106B of the Act. The trial judge further found that upon doing so, the family trust should be treated as Dr and Mrs Spry's property for the purpose of the family law proceedings.
- Dr Spry's appeals to the Full Court and High Court were dismissed.

Relevant law

- When determining property orders, the Family Court's general approach is to identify the net value of the property belonging to the marriage (the asset pool), and then determine what proportion of this each party should hold considering factors such as incomes, care of children and financial responsibilities.
- Parties are often in dispute about what property should be considered to belong to the marriage and included in the asset pool. In order to quarantine property from being included, parties may attempt to transfer it to another's name.

Setting aside commercial transactions under *Family Law Act 1975*

- Section 106B of the Act provides that the court may set aside the making of an instrument or disposition by a party which is made to defeat an existing or anticipated order in family law proceedings or which, irrespective of intention, is likely to defeat any such order.
- This will occur where the instrument or disposition disposes of the couples' property, so that court orders regarding property division are largely ineffective as there is little property to divide. This can include circumstances where, for example:
 - the party transfers assets or funds to a third party
 - the party removes the other spouse from a family trust
 - the party distributes funds from a family trust into individual trusts for the parties' children, thereby excluding the other spouse from beneficial title. This was the situation in the recent case of *Spry v Kennon*.

When will a transaction be able to be set aside under s106B?

Commercial lawyers should be aware that clients' property transactions may be set aside if performed when future family law proceedings are foreseeable, and the transactions are likely to defeat property orders made by the court in such proceedings. There are essentially three requirements for the Court to order a transaction to be set aside:

- The client must be involved in family law proceedings under the *Family Law Act*. If the client and their spouse never come before the Family Court, their spouse cannot challenge the transaction.
- There must be an instrument or disposition to be set aside, which must have been made by, on behalf of, by direction of or in the interest of a party to the proceedings.
- The instrument or disposition must be made with the intention of defeating an anticipated order in the proceedings. Under the judgment in *Plugradt* (1981), the test for 'anticipated' is objective i.e. whether, considering all of the circumstances at the time of the disposition, it was objectively foreseeable or expected as being likely or reasonably probable that proceedings would take place and orders consequently made.



Family trusts and family law

- A key question arising in family law is whether family trusts should be included in the parties' asset pool. The judgment of Kennon v Spry made a significant decision in this regard. This involved circumstances where the husband was the trustee but not a beneficiary of the family trust, and the wife was a beneficiary along with their four children and the husband's siblings. The husband had relinquished his beneficiary interest in the trust in 1983 for land tax purposes.
- In a 4-1 majority, the High Court found that the trust asset should be included in the couple's asset pool. In the leading judgment, French CJ found this was because:
 - the husband held legal title to the trust
 - the husband had absolute power to appoint the whole of the fund to his wife at his discretion (thus distinguishing it from charitable or non-discretionary trusts)
 - as a beneficiary, the wife held equitable rights of due consideration and due administration in the trust
- French CJ found that the treatment of the trust as property belonging to the parties was also supported by other factors, including that:
 - the Trust assets were largely acquired during the marriage,
 - there were no other equitable interests in them, and
 - the husband was under no obligation to apply any of the assets to any other beneficiary.

Commercial lawyers should therefore be aware that if clients' assets are largely held in a family trust and the client becomes involved in family law proceedings, the court may order that the assets of the trust be divided between the parties if the above circumstances exist - even if the client is the trustee but not a beneficiary of the trust.

Bankruptcy and family law

Position of bankrupt spouse

- Upon bankruptcy, the bankrupt's property vests in the trustee in bankruptcy. If the non-bankrupt spouse initiates family law proceedings against the bankrupt, the trustee in bankruptcy is able and at times obliged to participate in the proceedings. However, the trustee does not have the ability to bring family law proceedings against the non-bankrupt spouse ('NBS').

Position of the non-bankrupt spouse

- Changes to law introduced in 2005 have given the Family Court jurisdiction to adjust property interests of bankrupt parties—even in property that had vested in the trustee.
- This means that if a NBS applies for and is awarded orders for property or maintenance against the bankruptcy trustee, the NBS can obtain a claim to property and assets of the marriage that they otherwise would probably lose through the bankruptcy if the couple remained together.
- Moreover, under s72(2) of the FLA, the Court may require that spousal maintenance orders be satisfied by the transfer of vested bankruptcy property to the NBS. This will secure the NBS' maintenance claim where periodic payments would be impracticable due to the bankruptcy, and will reduce the pool of vested property available to creditors.
- It also may be possible for the Court to require that the bankrupt meet payments owing to the NBS under property orders out of property that has not vested in the bankruptcy trustee i.e. superannuation. Such a step would require a good deal of consideration for public policy, and has not been developed as yet.
- The 2005 changes also allow the NBS to commence family law proceedings for property settlement or spousal maintenance even after the other party has been declared bankrupt.



Commercial lawyers should be aware that the non-bankrupt spouse may be in a better financial position if they separate from the bankrupt and issue proceedings for property and maintenance orders against the bankrupt. However it is also important to note that orders are made entirely at the Court's discretion. Therefore if the Court suspects that the parties have separated and issued proceedings in order to quarantine assets from creditors, it may adjust orders accordingly. As below, creditors and the trustee in bankruptcy can make submissions to the Court regarding their interests.

Position of other creditors

- The Family Court's power to adjust interests in property vested in the bankruptcy trustee obviously affects the interests of other creditors, as orders granting property interests to the NBS it may reduce the assets available to be distributed between the creditors. Therefore s 75(2)(ha) was also inserted into the FLA in 2005, requiring the Court considers the effect of any proposed order on the ability of a creditor to recover debt owed to them.
- Little guidance has been given to how the court should consider creditors' interests or balance these against the NBS's. The bankruptcy trustee will generally be added as party to the proceedings and given opportunity to make submissions on this matter. Creditors can also apply to intervene in proceedings as parties whose interests may be affected by the proceedings.

Commercial lawyers should be aware that if their clients are owed money, (especially unsecured debt) by a party involved in family law proceedings, their recovery of this debt may be affected by the outcome of these proceedings. The clients may apply to be added to and make submissions in the proceedings in this regard. In any case, it is important for creditors to stay aware of their debtors family law matters if possible.

Injunction to preserve marital property pending Family Court orders

- In the case of *Depute Commissioner of Taxation v Kliman and Kliman* (2002) FLC 93-113, the Full Family Court considered the question of whether the Court had jurisdiction to grant a third party creditor an injunction restraining the husband and wife from disposing of their property pending the outcome of their family law property dispute.
- The Court found that it was able to grant such an injunction where the third party had an existing legal entitlement as against a party to the marriage, which clearly impacted what would be considered as property of the marriage without further adjudicative determination i.e. where the Court would not have to hear and consider what the third parties' property rights are.
- In this case the third party's property rights were a tax debt owed by the husband to the Deputy Commissioner of Taxation under Supreme Court orders.

Quarantining property through maintenance

- During bankruptcy, bankrupts are required to contribute to their debt a proportion of their income which exceeds the statutory amount. However, under s 139N *Bankruptcy Act 1966*, sums of money that the bankrupt is liable to pay under maintenance agreements or Family Court orders are exempt from the calculations of how much income the bankrupt is required to contribute. The amount that may be exempt from such calculations is capped at the maximum amount otherwise payable under the *Child Support Assessment Act*.
- Maintenance agreements made through a Binding Financial Agreement (BFA) is are now excluded from the definition of 'maintenance agreement' for the purpose of s 139N *Bankruptcy Act 1966*. Therefore maintenance payable under a BFAs will not be exempt from contribution calculations; so maintenance must be provided under family court orders to utilise s 139N *Bankruptcy Act 1966*.



Therefore, family court orders for maintenance may result in a decrease in the bankrupt's contribution to their debt, and may secure the NBS' maintenance is paid where the bankrupt may otherwise not have afforded this after making contribution to their bankruptcy.

As outlined below, creditors may apply to set these orders and BFAs for maintenance aside in certain circumstances. Therefore court orders and BFAs regarding maintenance should only be entered on a genuine basis and with consideration to its effect on creditors.

Quarantining property by transferring it

- The trustee in bankruptcy can increase the bankrupt's assets by setting aside transfers in the five years prior to the bankruptcy that were made by the bankrupt to another for less than market value consideration. This includes transfers made between the bankrupt and their spouse.
- However, if the transfer was made pursuant to Family Court orders, it can only be set aside if the trustee applies to the Family Court under s 79A *Family Law Act 1975* and can show that, for example, there has been a miscarriage of justice or that circumstances have changed to make the order impracticable (see more below).
- If the transfer was made pursuant to a binding financial agreement (which does not require that the parties be separated), it can only be set aside if the third party creditor applies to the Family Court under s 90K(1) of the *Family Law Act 1975* and can show that this was made with the purpose of defeating creditors.

Therefore if bankruptcy is likely for a party and they wish to transfer property to their spouse, the transfer will be more protected executed through the Family Court orders or a BFA, rather than privately. However, as outlined below, this may be overturned by Court upon application by creditors.

Creditors' ability to challenge property transfer orders and agreements

- While the above may be useful mechanisms for quarantining property from bankruptcy proceedings, it is important to note that creditors are able to challenge these on certain grounds:
- Binding Financial Agreements: section 90K(1) of the *Family Law Act* now allows third party creditors and government agencies acting in the interests of a creditor to apply to the Family Court to set aside BFAs on the grounds that they were made for the purpose of defrauding or defeating creditors, or with reckless disregard to the interests of creditors.
- Family Court Orders: section 79A of the *Family Law Act* allows third party creditors who may not be able to recover their debt because of a court order has been made to apply for the court order to be set aside. To do so, the creditor must show that there are circumstances such as a miscarriage of justice by reason of fraud, duress or suppressed or false evidence, or that circumstances have changed to make the order impracticable. As outlined below, failing to disclose existence of evidence may constitute miscarriage of justice under *Official Trustee in Bankruptcy v Bryan*.

If creditors suspect debtors are using maintenance or property transfers to avoid paying bankruptcy debts, they may be able to challenge the orders or agreement providing for the maintenance.

If parties are going to transfer property or pay maintenance through a BFA, and they or their spouse is bankrupt or likely to become bankrupt, they must ensure this transaction does not appear to be for the purpose of defeating a creditor.

Property transfers and maintenance payments made under Family Court orders are more protected from challenge by creditors; however may be set aside for exceptional reasons listed in 79A *Family Law Act*.



Duty to give Court notice of debts

- As the above shows, Family Court property orders will be quite difficult to reverse. Accordingly it is imperative that the Family Court is aware of all third party creditors and debts before making orders, to ensure creditors are given adequate consideration.
- This issue was raised in the case of *Official Trustee in Bankruptcy v Bryan* (2006) FLC 93-258. In this case, the husband and wife entered consent orders in 1992 that which provided that the husband must transfer his interest in jointly owned real estate to the wife. At this time both parties were aware that the husband had two substantial creditors, but did not disclose this to the Court.
- The creditors had lodged a caveat on the property, however this lapsed in 1997 and the parties executed the transfer after this date.
- The husband was eventually made bankrupt by petition of his creditors. The Trustee in Bankruptcy applied for the 1992 consent orders to be set aside, arguing that the failure to disclose the existence of the creditors constituted a miscarriage of justice for the purpose of s79A FLA.
- The Court held that there was a deliberate and intentional suppression of evidence by the parties, and that this caused a prejudice to unsecured creditors. The Court concluded such failure to make full and frank disclosure will ordinarily amount to a miscarriage of justice, and that it did so in this case.
- The Court consequently ordered that the 1992 consent order be set aside to the extent that it related to the husband's transfer of interest in the real estate.

Client's involved in Family Court proceedings must be fully aware of, and fully disclose to the Court, all of their creditors. If they fail to do so and subsequently become bankrupt, the Trustee in Bankruptcy may apply to the Court to have the orders set aside under s 79A.

Bankruptcy and resulting trusts

- Where a party's contribution to the purchase of a property is not reflected in legal title to the property, they may claim that they have a beneficial interest through a resulting trust. For example, if a wife contributes 50% of the purchase price of a property but it was registered solely in the husband's name, the wife could claim that the husband holds the property on trust for both himself and the wife in equal shares.
- Moreover, case law has recognised parties' contributions to property may be in forms other than supplying the purchase price. In *Cummins*, the High Court found that it is often incidental who makes payments for the property in a marriage, as the nature of a marital relationship often means incomes are pooled and then applied to bills and purchases arbitrarily. The High Court accordingly found that assets in a marital relationship can be presumed to be held on trust for both parties in equal shares, despite who holds legal title and who made direct contribution to the purchase price.
- This may mean that where the property is held solely in the bankrupt's name, the NBS may be considered to be entitled to one half of this under a resulting trust... therefore quarantining this half from vesting in the bankruptcy trustee.
- On the alternative, it may mean that where the property is held solely by the NBS, the bankruptcy trustee may claim that this is held on trust for the bankrupt as well, so the bankrupt's creditors are entitled to one half of this.

