

RECENT DEVELOPMENTS IN FAMILY LAW: BANKRUPTCY, THIRD PARTIES AND OTHER MATTERS

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In this paper I propose to discuss developments over the last 12 months in several areas of Family Law Financial Proceedings, and in particular:-

1. The bankruptcy amendments;
2. The new third party jurisdiction;
3. The “adding back” of notional property to the divisible pool;
4. Punishment for contempt.

I will not address superannuation splitting, which is to be dealt with in another seminar in this series.

The Bankruptcy Amendments

The *Bankruptcy and Family Law Legislation Amendment Bill* 2004 was introduced into the Senate on 7 November 2004. It passed the Senate, with amendment, on 9 February 2005, and was introduced into the House of Representatives on 10 February 2005. It passed the House, with further amendments, on 17 February 2005. The Senate agreed to the House amendments on 9 March 2005. The Act received Royal assent on 18 March 2005, and most of the amendments commenced on 18 April 2005.

The amendments allow non-bankrupt spouses to make an application for property settlement under the (CTH) *Family Law Act* 1975 in the Family Court, even though their spouse was bankrupt, or was a debtor subject to a personal insolvency agreement, at the time the application is made. In such circumstances, the bankruptcy trustee becomes a party to the Family Law proceedings. As the property of the bankrupt spouse will have been vested in the trustee, the non-bankrupt spouse will, in effect, be applying for orders adjusting the interests of the trustee in the vested bankruptcy property.

The explanatory memorandum recognises that from a bankruptcy perspective, trustees can find themselves in an uncertain position when having to resolve or reconcile competing claims, and creditors unaware of the potential property interests of a non-bankrupt spouse also suffer from a lack of certainty. On the other hand, from a Family Law perspective, the legal (and equitable) ownership of property does not always reflect the non-financial contributions of the parties to a marriage, and the special interest of the non-bankrupt spouse in matrimonial property - created through

both financial and non-financial contributions - which is recognised by the Family Court in exercising its discretion to alter property interests, is not expressly recognised under the (CTH) *Bankruptcy Act* 1966. Different results may arise, depending upon the order of events - those events including separation, bankruptcy and distribution of property by the trustee in bankruptcy. The amendments are intended to address these issues by clarifying the respective rights of the bankruptcy trustees and the non-bankrupt spouse, and enabling concurrent bankruptcy and family law proceedings to be brought together, to ensure all issues are dealt with at the one time.

Amendments to the *Family Law Act* include the following:-

- Introduction of a new definition, in s.4(1), of what is a bankruptcy trustee: “bankruptcy trustee”, in relation to a bankrupt, means the trustee of the bankrupt’s estate;
- Insertion of a definition in s.4(1) of what is meant by a “debtor subject to a personal insolvency agreement”;
- Insertion of a new matrimonial cause (caa), namely proceedings between a party to a marriage and the bankruptcy trustee with respect to the maintenance of that party;
- Insertion of a new matrimonial cause (cb), namely proceedings between a party to a marriage and the bankruptcy trustee with respect to the vested bankruptcy property of the bankrupt spouse;
- Insertion of a definition of “personal insolvency agreement”, by cross reference to the *Bankruptcy Act*. These are so-called “Part X” arrangements;
- Insertion of a new definition in s.4(1) of “property settlement proceedings”, being proceedings with respect to the property of the parties to the marriage or with respect to vested bankruptcy property in relation to a bankrupt party to a marriage;
- Insertion of a new paragraph (aa) in the definition of property settlement and spousal maintenance proceedings to include vested bankruptcy property in relation to a bankrupt spouse;
- Insertion of a definition of “trustee” in relation to a personal insolvency agreement, by cross reference to the *Bankruptcy Act*;
- Insertion of a new definition of “vested bankruptcy property”, being property of the bankrupt that has vested in the bankruptcy trustee under the *Bankruptcy Act*, for which purpose “property” has the same meaning as in the *Bankruptcy Act*;

- Insertion of a new s.5 defining what is a “debtor subject to a personal insolvency agreement”;
- Amending s.44(3), (3A) and (3B) to substitute reference to matrimonial cause (ca) with “(caa), (ca) or (cb)”;
- Insertion of a new s.45(1A) extending a court’s power to stay or transfer proceedings where a bankruptcy trustee applies for an order under *Bankruptcy Act*, s.139A, so that proceedings relating to such application are taken to be proceedings in relation to the marriage;
- Insertion of a new s.71A(2), to make clear that the amendments to various sections in Part VIII are to apply to proceedings under the new matrimonial causes (caa) and (cb), notwithstanding the provisions of Part VIIIA dealing with financial agreements, so that it is not possible for parties to use a BFA (Binding Financial Agreement) relating to property or financial resources that is the subject of those proceedings to prevent a court dealing with that property or financial resource in accordance with the amendments;
- Insertion of a new s.72(2), providing that the liability of a bankrupt party to a marriage to maintain the other spouse may be satisfied in whole or in part by way of transfer of vested bankruptcy property;
- Amendment of s.74, dealing with spouse maintenance, so as to provide, by new s.74(2), that the bankruptcy trustee must be joined as a party to the proceeding where the court is satisfied that the interests of the bankrupt’s creditors may be affected by an order and the application for spouse maintenance was made while the party was a bankrupt or the party became a bankrupt after the application was made but before the proceedings were finally determined. New s.74(3) provides that if the bankruptcy trustee is joined as a party under (2), then the bankrupt is not entitled to make submissions to the court in the proceedings in connection with any of the vested bankruptcy property, except with the leave of the court. Thus the bankruptcy trustee, rather than the bankrupt spouse, becomes the relevant party. Such leave is to be granted only in exceptional circumstances (for example where the bankrupt has exclusive knowledge of facts or matters relevant to the proceedings). New subsections (5), (6) and (7) make similar provision in the case of personal insolvency agreements.
- Insertion of new s.75(2)(ha), providing that a court must take into account the effect of any proposed order on the ability of a creditor of a party to recover the creditor’s debts. This is intended to require the courts specifically to consider any moneys owed by a party to a creditor and the impact of any proposed order on the ability of the creditor to recover any such debt;
- Amendment of s.75(2)(n) to require the court to consider any order made in relation to vested bankruptcy property of the bankrupt spouse;

- Amendment of s.79(1), to extend s.79 proceedings to include proceedings for the alteration of the interests of the bankruptcy trustee in the vested bankruptcy property, including to require the bankruptcy trustee to make such settlement or transfer of property as the court determines for the benefit of *either* party to the marriage, or child of the marriage;
- Insertion of new s.79(4)(ea), requiring the court to take into account in making an order under s.79 the effect of any proposed order on the ability of a creditor of a party to the marriage to recover the creditor's debt. This duplicates new s.75(2)(ha), and is intended to require the court specifically to consider when making an order in property settlement proceedings any moneys owed by a party to a creditor;
- Insertion of new subsection (10A), so that s.79(10) - to be introduced by the *Family Law Amendment Bill 2004* - will provide that a creditor of a party to property proceedings under s.79, or any other person whose interests would be affected by the making of the order, may apply to become a party to those proceedings - will not apply to allow a creditor whose debt is a provable debt against a bankrupt spouse to become a party. Instead, the bankruptcy trustee will represent the interests of the creditor;
- Insertion of new s.79(11), which will require that the bankruptcy trustee be joined as a party upon application by the bankruptcy trustee where the court is satisfied that the interests of the bankrupt's creditors may be affected by an order and the application was made whilst the party was a bankrupt or the party became a bankrupt after the application was made but before the proceedings were finally determined. Section 79(12) provides that if the bankruptcy trustee is so joined then the bankrupt is not entitled to make submissions except with the leave of the court to be granted only in exceptional circumstances. Section 79(14), (15) and (16) make similar provision in respect of spouses who are subject to personal insolvency agreements;
- Insertion of new s.79A(5), (6) and (7), which will make clear that a bankruptcy trustee is a person whose interests are affected by an order under s.79, where a party to the marriage was bankrupt at the time the order was made, or the party became a bankrupt after the order was made;
- Insertion of new notification sections 79G, 79H and 79J, which provide that the rules of court may make provision for a bankrupt spouse, or a spouse subject to a personal insolvency agreement, to give notice of relevant applications to the bankruptcy trustee, or to the court.

Separately, the Act contains amendments designed to facilitate upsetting financial agreements which defeat creditors. Financial agreements under Part VIIIA will be excluded from the definition of "maintenance agreement" in the *Bankruptcy Act*, so that trustees will be able to use the provisions of that Act to recover property transferred by the bankrupt prior to the commencement of bankruptcy. A new act of

bankruptcy is created, where a person is rendered insolvent as a result of assets being transferred pursuant to a Part VIIIA financial agreement.

In short, the principal effect of the amendments is to provide for spouse maintenance and property settlement proceedings to be brought by a non-bankrupt spouse against the bankrupt spouse's trustee, and obtain adjustive property orders against the vested bankruptcy property. There is no corresponding right of the bankruptcy trustee to bring property settlement proceedings against the solvent spouse.

Questions have been asked as to how the court will balance the interests of the creditors in respect of the vested bankruptcy property, with those of the non-bankrupt spouse. Nabil Wahhab has written:¹

One wonders how the Family Court will balance the interests of the creditors in respect of the property that has vested in the bankruptcy trustee and the non bankrupt spouse. What will be the asset pool that the court will seek to settle where the liabilities exceed the assets? Will the Family Court ignore part of the liabilities of the bankrupt in order to effect a property settlement in favour of the non bankrupt spouse? How will the Family Court assess the non bankrupt spouse's non-financial contributions as well as the home maker and parenting role?

I venture some answers to these questions.

The asset pool should be the gross assets of the parties, including the gross assets in the bankrupt estate. This is appropriate, because unsecured creditors do not have a proprietary interest in their debtor's property. The court should then consider what order it would have made, had the bankrupt spouse not become bankrupt. *Ex hypothesi*, the court must disregard the liabilities (which will necessarily exceed the assets of the bankrupt spouse), since otherwise no order would ever be made. Having decided what order would have been made but for the bankruptcy, the court should then treat it as if it were a provable debt in the bankruptcy, so that it abates pro rata with the liabilities that have been proven in the bankruptcy.

At first sight, such an approach allows the new provisions to work, while at the same time taking into account the interests of creditors. If in the first step, the bankrupt's liabilities were not disregarded, no order could ever be made. If in the second step, the same order were made as would have been made had there been no liabilities, then the command to take into account the interests of the creditors would be defeated. Accordingly, an approach which either precisely or approximately pro-rates the available property between the claims - an approach well familiar to the law of bankruptcy - accommodates both concerns.

¹ *The Clash of the New Millenium: Bankruptcy v Family Law*, CCH Family Law News, Issue 460, p.3.

The New Third Party Jurisdiction

The *Family Law Amendment Act 2003* received assent on 17 December 2003. New provisions, introducing a new matrimonial cause – “third party proceedings to set aside a financial agreement” – and amending Part VIIIA to authorise applications by creditors to set aside financial agreements which defraud or defeat creditors – commenced on assent. But commencement of the provisions of new Part VIII AA, which confer on the court power to bind third parties in financial and injunctive proceedings, was deferred until 17 December 2004. So far as the author is aware, there have not yet been any judicial decisions on Part VIII AA. Practitioners seem keen to avoid invoking it if they can, preferring to rely on well-established means of affecting third parties where possible. This approach is a prudent and sensible one.

The powers of the Family Court have always been capable of directly or indirectly affecting third parties, and, at least in limited circumstances, the Court has always been able to make orders binding parties other than the spouses. However, such powers as the Court has hitherto had to bind third parties – for example under s.78, (former) s.85 (now s.106B), and s.114 - have been reasonably incidental to the matrimonial cause between husband and wife. New Part VIII AA goes much further, because it authorises discretionary interference with the rights and powers of third parties. It has the potential to have a considerable impact on practice, and greatly increase the involvement of third parties in property litigation in the Family Court.

The existing third party property jurisdiction

The Family Court is not without power to bind third parties, even absent proposed Part VIII AA. Although the general notion of a matrimonial cause is a proceeding between husband and wife, the reality of modern life is that the financial affairs of husbands and wives include and involve family companies and family trusts, and are intertwined with the financial and property interests of other family members, “outsiders”, and creditors. The interests of third parties who have commercial or personal relationships with one or more of the spouses may often be liable to be affected by the resolution of the matrimonial dispute. This is so in relation to both relatives and family companies closely connected with one or both of the spouses; and arms-length third parties such as creditors.

It has always been the case that the Family Court can make orders which have an indirect effect on a third party, and in some circumstances may make orders directly against third parties. The court has always, to some extent, had power to bind third parties, particularly by injunction on an interlocutory basis.² More direct incursions

² See *Sanders v Sanders* (1967) 116 CLR 366; *Antonarkis v Delly* (1976) 1 Fam LR 11, 334; FLC ¶90-063 (in which the court upheld the power under (CTH) *Matrimonial Causes Act 1959*, s.124 to grant injunctions against third parties and said that the power extended to the granting of permanent injunctions; a wife obtained an order against her mother-in-law and the husband’s step-brother to vacate the matrimonial home); *R v Dovey; ex parte Ross* (1979) 5 Fam LR 1, FLC ¶90-616 (in which the Court held that an injunction may be granted to restrain a party from using his influence or control over a company which owned the matrimonial home to evict the wife).

on the rights of third parties were authorised by s.85, now s.106B. The jurisdiction to make orders which affect the rights of third parties was established even before the *Family Law Act*. In *Sanders v Sanders*,³ an order had been made under (CTH) *Matrimonial Causes Act* 1959, s.124 (the almost identical predecessor of *Family Law Act*, s.114(3)), for the transfer by the husband to the wife of a leasehold property which comprised the former matrimonial home. After the order was made, but before the transfer was effected, the house, which was insured, was destroyed by fire. The wife sought an interlocutory injunction to restrain the insurance company from paying out the insurance moneys to the husband or any other person. The High Court upheld the grant of the injunction. Barwick CJ, with whom McTiernan and Windeyer JJ agreed, said:-⁴

That power may be exercised to maintain an existing situation until the Court can decide what should be done upon the substantive application for maintenance, even though its exercise involves third parties, and the rights of any such party or parties in relation to one or both of the parties to the matrimonial cause, or in relation to the property of one or both of those parties.

However, particularly in the context of s.114, limitations on the Court's power to affect third parties have been imposed by the decision of the High Court of Australia in *Ascot Investments Pty Ltd v Harper*.⁵ There, the High Court held that, though the Family Court may grant an injunction directed to a third party, or which may indirectly affect the position of a third party, it cannot do so if its effect would be to deprive a third party of an existing right, or to impose on a third party a duty which the third party would not otherwise be liable to perform. Gibbs J, as he then was, said in a well known passage:-⁶

The authorities to which I have referred [namely, *Sanders v Sanders*,⁷ *Antonarkis v Delly*,⁸ *R v Ross Jones; ex parte Beaumont*,⁹ and *R v Dovey, ex parte Ross*,¹⁰] establish that in some circumstances the Family Court has power to make an order or injunction which is directed to a third party or which will indirectly affect the position of a third party. They do not establish that any such order may be made if its effect will be to deprive a third party of an existing right or to impose on a third party a duty which the party would not otherwise be liable to perform. The general words of ss. 80 and 114 must be understood in the context of the Act, which confers jurisdiction on the Family Court in matrimonial causes and associated matters, and in that context it would be unreasonable to impute to the Parliament an intention to give power to the Family Court to extinguish the rights, and enlarge the obligations, of third parties, in the absence of clear and unambiguous words.

³ (1967) 116 CLR 366.

⁴ (1967) 116 CLR 366, 372.

⁵ (1981) 148 CLR 337; 33 ALR 631; 6 Fam LR 591; FLC ¶91-000.

⁶ (1981) 148 CLR 337, 354; 33 ALR 631, 643; 6 Fam LR 591, 601; FLC ¶91-000, 76061.

⁷ (1967) 116 CLR 366.

⁸ (1976) 1 Fam LR 11, 334; FLC ¶90-063.

⁹ (1979) 141 CLR 504; 23 ALR 179; 4 Fam LR 598; FLC ¶90-606.

¹⁰ (1979) 141 CLR 526; 5 Fam LR 1; FLC ¶90-616.

Section 78(1) expressly authorises the court, in proceedings between the parties to a marriage with respect to existing title or rights in respect of property, to declare the title or rights, if any, that a party has in respect of property. On its face, this is not limited to the rights of each party *vis a vis* the other, but embraces the rights of one party *vis a vis* a third party. Section 78(2) then authorises consequential orders to give effect to the declaration.

Formerly, s.78(3) provided that such a declaration was binding on the parties to a marriage but not on any other person.¹¹ However, s.78(3) was repealed by the *Law and Justice Legislation Amendment Act 1988*, s.39, in respect of proceedings instituted after its commencement. The explanatory memorandum at that time stated that the repeal of s.78(3) would enable the court, in appropriate cases, to make orders that are binding on third parties as well as the parties to a marriage. The then Attorney-General, Mr Bowen, repeated those observations in his second reading speech,¹² adding:-

Many Family Law property disputes involve adjudication of the rights of the parties to a marriage as between themselves and third parties, such as banks. As the Act presently stands, third parties may intervene in proceedings under the Act pursuant to section 92, but may not be bound by any order of the court as a consequence of sub-section 78(3). The present lack of power to make binding determinations about the existence and extent of the rights and liabilities of third parties can be frustrating for both the court and the parties as well as adding to the expense of proceedings. For example even if a court concludes that particular property does not belong to either party to the marriage but to a third party, the court cannot, because of sub-section 78(3), make any declaration or order in favour of the third party.

Since the repeal of s.78(3), there is nothing in the wording of the Act to prevent declarations being made under s.78 which bind third parties. In *Warby & Warby*,¹³ the Full Court, in the course of considering the availability of accrued jurisdiction, adverted to this point in the following terms (at [87]):-

[87] Seventhly, there is the issue of the Family Court of Australia's capacity to adjudicate and make orders with respect to third parties. The wife's submissions conceded that orders may in limited circumstances affect the rights of third parties and that is clearly correct. Section 78 of the *Family Law Act* confers the power to make a declaration with respect to existing title or rights. Since the amendment of the Act in 1988, the provision is not expressly confined to the property of the parties to the marriage or either of them and there is no authority which says that such a declaration may not bind a third party. Relevantly too, the *ratio decidendi* of *Gould & Gould; Swire Investments Ltd*,¹⁴ makes clear that this is within the constitutional power of the Commonwealth parliament insofar as s.85 (as it then was) of the *Family Law Act* is concerned and, by way of *obiter dicta*, such validity should be

¹¹ *Balnaves & Balnaves* (1988) 12 Fam LR 488; FLC ¶91-952.

¹² *Representatives Hansard*, 10 November 1988, p2840.

¹³ [2001] FamCA 1469; (2001) 166 FLR 319; (2001) 28 Fam LR 443; (2002) FLC ¶93-091 (Nicholson CJ, Finn and Strickland JJ).

¹⁴ (1993) FLC ¶92-434.

assumed with respect to the exercise of other powers conferred by Part VIII of that Act.

Thus, the Family Court can, pursuant to s.78, 106B and 114, at least to some extent already bind third parties. However, it had no power to alter third party rights (save that it could set aside dispositions to third parties which defeat claims under the Act).

Part VIII A A

The essential intent of new Part VIII A A was explained in the Explanatory Memorandum which accompanied the *Family Law Amendment Bill 2003*, in the following terms:-

General outline

In line with the Government's ongoing reform agenda in Family Law, this Bill makes a range of amendments to the *Family Law Act 1975* (the Act). In particular the Bill makes a range of reforms to clarify those provisions of the Act dealing with property and financial interests.

Of particular importance are the provisions in the bill that provide clear power for courts exercising jurisdiction under the Act to make orders binding on third parties when dealing with property settlement proceedings under the Act. The provisions make it clear that within defined limits courts will have power to make orders binding on persons such as creditors to one party to a marriage and companies to do certain things.

...

Allow for orders and injunctions to be binding on third parties

Schedule 6 of the bill provides for the Family Court to be given power to bind third parties in order to give effect to property settlements. This will apply for any creditor of a party to a marriage irrespective of whether the creditor is a friend, relative or financial institution. Procedural rights will be given to third parties to ensure that the changes do not affect the underlying substantive property rights of the creditor.

The relevant amendments are to be found in Schedule 6, which inserts, after s.90, the new Part VIII A A, entitled "Orders and Injunctions binding Third Parties". The explanatory memorandum states that Schedule 6 amends the Act to give the court power to bind third parties in order to give effect to property settlements, observing that at present the court may be unable to direct a third party to act in order to give effect to property settlements. The amendments are said to allow a court to make orders generally that direct a third party to do something in relation to the property of a party to the marriage or that alter the rights, liabilities or property interests of a third party in relation to a marriage. They will allow the court to make an order that would, for example, have the effect of altering the terms of a contract between the parties to a marriage and a creditor. For example, it is said, a court could order that one of the

spouses was no longer liable to the creditor for a joint debt, while the other spouse was liable for the whole debt. (The potential for extensive invocation of this provision is self-evident). Further, it is said that the court could order directors to register a transfer of shares, or restrain a company from taking action against a party to a marriage. The explanatory memorandum points out that the amendments will only allow the court to make such orders in limited circumstances; that a court could not simply cancel the debts of the parties; and that third parties must be accorded procedural fairness - primarily meaning that they must be notified and be given a right to be heard before any order is made against their interests.

Section 90AA provides that the object of Part VIII AA is to allow the court, when it is either making orders altering property interests in respect of the parties to a marriage under s.79, or making an order or injunction under s.114 (which authorises orders or injunctions relating to the personal protection of a party to the marriage, restraining a party from particular actions, protection of the marital relationship, personal property of the party to a marriage, or the use or occupancy of the matrimonial home), to make an order under s.79 or s.114, or grant an injunction under s.114, that is directed to, or alters the rights, liabilities or property interests of, a third party.

Section 90AB provides a definition of “marriage” – which is taken to include void marriages; and “third party”, which is defined to mean a person who is not a party to the marriage – and therefore includes individuals (including friends or relatives of the parties to the marriage, businesses, and financial institutions).

The overriding power

By s.90AC, the new part is given effect “despite anything to the contrary in any other law, whether written or unwritten, of the Commonwealth, a State or Territory, or anything in a trust deed or other instrument, whether made before or after the commencement of the Part VIII AA”; and nothing done in compliance with Part VIII AA by a third party is to be treated as resulting in a contravention of any such law or instrument. Section 90AC thus makes it clear that in the event of inconsistency with other instruments or laws, Part VIII AA is to override any other law of the Commonwealth or a State or Territory, or any trust deed or other instrument, even where it is made after the commencement of Part VIII AA. Further, when complying with Part VIII AA, a third party will not be taken to contravene any other law or instrument.

Section 90AD provides that, for the purposes of the part, a debt owed by a party to a marriage is to be treated as property for the purposes of matrimonial cause (ca), and for the purposes of s.114(1)(e). Thus, s.90AD has the effect that a *debt owed by a party to a marriage* is to be treated as *property* for the purposes of the definition of “matrimonial cause” in paragraph (ca) of the definition of that term, which relates to proceedings between parties to a marriage with respect to the *property* of parties to the marriage. Similar provision is also made in respect of injunctions in relation to the property of a party, for the purposes of s.114(1)(e).

What orders can be made in s.79 proceedings

Division 2 deals with orders under s.79. By s.90AE, the court is empowered to make orders:-

- (a) directed to a creditor of the parties to the marriage, to substitute one party for both parties in relation to the debt owed to the creditor;
- (b) directed to a creditor of one party to a marriage, to substitute the other or both parties in relation to that debt;
- (c) directed to a creditor of the parties to the marriage, that the parties be liable for a different proportion of the debt owed to the creditor than the proportion the parties are liable to before the order is made; and
- (d) directed to a director of a company or to a company, to register a transfer of shares from one party to the marriage to the other.

The court is further empowered, in proceedings under s.79, to make any other order that:-

- (a) directs a third party to do anything in relation to the property of a party to the marriage, or
- (b) alters the rights, liabilities or property interests of a third party.

Some limitations are imposed by s.90A(3), which provides that the court may only make any such order if:-

- (a) the making of the order is reasonably necessary, or reasonably appropriate and adapted, to effect a division of property between the parties to the marriage; and
- (b) where the order concerns a debt of a party to the marriage, it is not foreseeable at the time that the order is made that to make the order would result in the debt not being paid in full; and
- (c) the third party has been accorded procedural fairness in relation to the making of the order; and
- (d) the court is satisfied that, in all the circumstances, it is just and equitable to make the order; and
- (e) the court is satisfied that the order takes into account the taxation effect (if any) of the order on the parties to the marriage and on the third party; the social security effect (if any) of the order on the parties to the marriage; the third party's administrative costs in relation to the order; if the order concerns a debt of a party to the marriage, the capacity of a party to the marriage to repay the debt after the order is made; the economic, legal or other capacity of the third party to comply with the order; if, as a result of

the third party being accorded procedural fairness in relation to the making of the order, the third party raises any other matters, then those matters; and any other matter that the court considers relevant.

In keeping with modern drafting practice, the Act contains some “examples”, although they are so mundane as to be of little utility. Thus, as to the requirement that the capacity of a party to the marriage to repay the debt after the order is made be taken to account, the example is given that the capacity of a party to the marriage to repay the debt would be affected by that party’s ability to repay the debt without undue hardship. As to the economic, legal or other capacity of the third party to comply with the order, the example given is that the legal capacity of the third party to comply with the order could be affected by the terms of a trust deed; however, after taking the third party’s legal capacity into account, the court may make the order despite the terms of the trust deed and if it does so, the order will have effect despite those terms.

Thus, s.90AE provides that when making an order altering the property interests of the parties to a marriage, the court has power to make an order binding a third party.

What orders can be made in s.114 proceedings

Division 3 deals with orders and injunctions under s.114. Section 90AF corresponds with s.90AE, and provides that in proceedings under s.114, the court may:-

- (a) make an order restraining a person from repossessing property of a party to a marriage, or
- (b) grant an injunction restraining a person from commencing legal proceedings against a party to a marriage, or
- (c) make any other order or grant any other injunction that directs a third party to do a thing in relation to the property of a party to the marriage, or alters the rights, liabilities or property interest of a third party in relation to the marriage.¹⁵

Again, limitations are imposed by s.90AF(3), which provides that the court may only make an order or grant an injunction of the type described if:-

- (a) the making of the order, or the granting of the injunction, is reasonably necessary, or reasonably appropriate and adapted, to effect a division of property between the parties to the marriage; and
- (b) where the order or injunction concerns a debt of a party to the marriage – it is not foreseeable at the time that the order is made, or the injunction granted, that to make the order or grant the injunction would result in the debt not being paid in full; and

¹⁵ S.90AF(2).

- (c) the third party has been accorded procedural fairness in relation to the making of the order or injunction; and
- (d) for an injunction or order under s.114(1) – the court is satisfied that, in all the circumstances, it is proper to make the order or grant the injunction; and, for an injunction granted under s.114(3) – the court is satisfied that, in all the circumstances, it is just or convenient to grant the injunction; and
- (e) the court is satisfied that the order or injunction takes into account its taxation effect, if any, on the parties to the marriage and on the third party; its social security effect on the parties to the marriage; the third party's administrative costs in relation to the order or injunction; if the order or injunction concerns a debt, the capacity of a party to the marriage to repay the debt after the order is made or the injunction is granted; the economic, legal or other capacity of the third party to comply with the order or injunction; if, as a result of the third party being accorded procedural fairness in relation to the making of the order or the granting of the injunction, the third party raises any other matters – those matters; and any other matter that the court considers relevant.

Substantially the same examples as are mentioned in s.90AE in respect of proceedings under s.79 are repeated in s.90AF in respect of proceedings under s.114.

Thus s.90AF provides that the court has discretion to make an order or grant an injunction binding a third party when making an order or injunction under s.114.

Other aspects

Division 4 deals with other matters. Section 90AG deals with orders and injunctions binding on trustees, and provides that if an order or injunction binds a person in the capacity of trustee in relation to property, then the order or injunction is also binding (by force of the section) of any person who subsequently becomes the trustee. Thus its effect is that successive trustees will be bound by orders or injunctions made under Part VIII A A.

Section 90AH is entitled "Protection for a Third Party", and provides that a third party is not liable for loss or damage suffered by any person because of things done (or not done) by the third party in good faith in reliance on an order or injunction made or granted by a court in accordance with Part VIII A A. In this way, it provides third parties with protection from liability for loss or damage suffered by any other person, where the third party is acting in good faith in reliance on a court order or injunction under Part VIII A A.

Service of documents on a third party is covered by s.90AI, which provides that if a document is required or permitted to be served for the purposes of the part on a third party, it may be served in any of the ways in which a document may be served under

the applicable rules of court, in addition to any other method of service permitted by law. Its effect is that documents should be served in accordance with applicable rules of court or other method of service permitted by law.

The expenses of the third party are addressed by s.90AJ, which has the effect that if the court has made an order or granted an injunction in accordance with Part VIII AA and a third party has incurred expense as a necessary result, the court may make such order as it considers just for the payment of the reasonable expenses of the third party incurred as a necessary result of the order or injunction. In deciding whether to do so, and subject to what the court considers just, the court must take into account the principle that the parties to the marriage should bear the reasonable expenses of the third party equally. Regulations are authorised to provide, in situations where the court has not made an order, for the charging by the third party of reasonable fees to cover the reasonable expenses of the third party incurred as a necessary result of the order or injunction; if such fees are charged, that each of the parties to the marriage is separately liable to pay to the third party an amount equal to half of those fees; and for conferring jurisdiction on a particular court or courts in relation to the collection or recovery of such fees.

Section 90AK provides that the court must not make an order or grant an injunction under Part VIII AA if the order or injunction would result in the acquisition of property from a person other than on just terms, and be invalid because of paragraph 51xxxi of the Constitution.

Part 2 of Schedule 6 of the Amending Act provides that, in general, the amendments apply to all marriages, including those that were dissolved before commencement, but not to a marriage if a s.79 order or a s.87 agreement is in force in relation to the marriage at the commencement time, unless such s.79 order is set aside under s.79A(1), or the approval of the s.87 agreement is revoked under s.87(8), in which case the amendments apply from the time the order is set aside or the approval is revoked. Thus the amendments apply to all marriages, including those dissolved or annulled before commencement date, unless there is an existing order or s.87 agreement in relation to the property of the marriage which has not been set aside or revoked.

Practical implications

The practical implications of Part VIII AA are extensive.

Possible uses of Part VIII AA orders – some of them expressly envisaged by the legislation and some not – include the following:-

- Under s.79, an order directed to a creditor, altering liability for a debt, by substituting one spouse for both as debtor, or substituting the other spouse or both for one as debtor, or making the spouse liable for different proportions of the debt

- Under s.79, an order varying the terms of repayment of a debt
- Under s.79, an order directed to a director of a company or to a company, to register a transfer of shares from one party to the marriage to the other – notwithstanding that the corporate constitution does not permit it, or permits the company to decline to register any transfer – or otherwise overriding restrictions on the transferability of shares
- Under s.79, in the context of family trusts, orders which fix a vesting date, or convert a discretionary trust into a fixed trust, or require the trustee to exercise its discretion in a particular manner, or add a beneficiary, or require a distribution to a spouse who upon divorce ceased to be a beneficiary
- Under s.79, requiring a consent to be given to a transfer of property
- Under s.114, an order restraining a mortgagee from taking proceedings for possession of the home – particularly on an interlocutory basis, pending finalisation of the s.79 proceedings;
- Under s.114, an injunction restraining a creditor from commencing proceedings against a spouse to recover a debt – again, particularly on an interlocutory basis pending finalisation of the s.79 proceedings.
- Credit providers will be exposed to credit risk, and there will be implementation and compliance costs. The court's power to bind third parties in relation to debt products and risks has led to concerns at "the potential for the court to substitute its commercial judgment for the commercial judgment of the bank and to leave the bank exposed involuntarily to a credit risk".¹⁶ Other third parties – co-debtors and guarantors who are jointly and severally liable for the debt – may also be disadvantaged. The Australian Bankers Association has pointed to the "erosion of the value of a bank's substantive right of property in debt", and argued that the amendments reduce a bank's ability to recoup the debt from parties whom the bank had originally determined were creditworthy, and may deprive the bank of recourse to one of the parties either fully or proportionally, and increase the exposure of the bank to credit risk.

The Senate Legal and Constitutional Legislation Committee reported on the bill in August 2003, recommending that it proceed, subject, relevantly, to the deferring of the operation of new Part VIII A for twelve months, and the following:-

3. **Binding of Third Parties to Orders and Injunctions:** the term "shares" be defined to include a legal or beneficial interest held in the capacity of trustee or otherwise in the share of the capital of a company.

¹⁶ *Senate Legal and Constitutional Committee Official Hansard* 22 July 2003, p L&C19.

It was the concerns outlined above, which were expressed to the Committee, that produced the provisions, now contained in s.90AE(3) and s.90AF(3), which endeavour to provide some protection for third parties.

Those concerns – the substance of which remains entirely valid – show that financial institutions will not readily accept that such orders should, as a matter of discretion, be made. The considerations and limitations imposed by the legislation provide them with a good basis for arguing their position. It can be anticipated that where such orders are sought, financial institutions will, at least initially, routinely oppose them.

On the other hand, it is frequently the case that a spouse remains exposed to a financier on a personal guarantee for a debt associated with property that the other will retain, and wishes not only to have an indemnity, but to be released from the debt. It can therefore be expected that in many cases where there is joint debt, the jurisdiction will be invoked by a party seeking an order that the other alone be responsible for the debt. Given the frequency with which orders are sought that one party indemnify the other in respect of liability under a mortgage over the home, orders of the type envisaged are likely to be sought, if not in every property case, then in a very high proportion of them. Notice to the relevant third party will be required, and it may be anticipated that financial institutions generally – and particularly in the early stages – will take a strict view of defending their legal position. Third parties may well become the rule, rather than the exception, in s.79 proceedings.

What is “just and equitable” or “proper” or “just and convenient”

According to the Explanatory Memorandum, the new powers are intended to cover a range of possible interests that a party to the marriage may have, including ownership of life insurance products which offer benefits similar to superannuation. They will have the consequence that lending institutions can be bound by court orders that make one of the parties liable for particular debts. The range of orders is intentionally broad and includes substitution of the party liable for a debt, adjusting the proportion of a debt that each party is liable for or ordering the transfer of shares between the parties to the marriage. The Explanatory Memorandum asserts that the provision is intended to apply only to the procedural rights of the third party and not to extinguish or modify the underlying substantive property rights of the third parties. However, the plain words of the section deny this proposition. But an order can only be made if it is reasonably necessary or appropriate to effect the division of property between the parties, and the third party must be accorded procedural fairness. The order cannot be made if it is unlikely that the result of the order would be a debt not being paid in full.

Within those limitations, when will the Court make such orders? The only available guidance at this stage is in the legislation and the explanatory memorandum. A cautious approach can be anticipated in the early days of the legislation, which will become more adventurous with the passage of time. The words “just and equitable”

in s.90AE, and “proper” and “just and convenient” in s.90AF respectively, are taken from the parent sections, s.79 and s.114. It may be doubted that they add much of significance to the other considerations specified in s.90AE and s.90AF. The more of those considerations as are satisfied, the more likely it is that the Court will make an order. If the words “just and equitable” have any role, they may mean that intervention will be more likely where the creditor is closely connected with the respondent spouse, or has somehow intermeddled in or taken advantage of the marriage breakdown, or where the creditor has acted with disregard to the interest of the applicant spouse, or where the debt is in substance (and/or will in future be) associated with property of one of the spouses only. Intervention will obviously also be more likely where its effect is only “procedural” and will not in substance deprive the creditor of its debt or security.

Constitutional validity

The likely popularity of these provisions may be anticipated to provoke a constitutional challenge sooner rather than later.

The passage from *Ascot Investments* which has been cited above supports the view that the Family Court cannot make an order which would adversely alter the rights of a third party. But that decision of the High Court was founded, not on constitutional limitations, but on construction of the Act, and the intention to be imputed to Parliament. New Part VIII AA evinces a plain intention to empower the Family Court to at least vary the rights, and reduce those rights, of third parties. The explanatory memorandum, in expressing the view that only procedural and not substantive rights are intended to be affected, understates the position. These amendments, if constitutional, plainly empower the court to vary and diminish the rights of third parties. There is no lack of clear and unambiguous words to do so. Any attack on their constitutional validity will have to go beyond *Ascot Investments*, to argue that s.90AE and s.90AF are not laws with respect to marriage, divorce, or matrimonial causes, or incidental thereto.

There is no absolute constitutional objection to orders being made under the *Family Law Act* which affect or bind third parties, so long as the proceedings in which they are made are a matrimonial cause. The power to legislate with respect to “matrimonial causes” includes matters incidental thereto. The general notion of a matrimonial cause is a proceeding between husband and wife. While there may be interveners, they are not the objects of the suit against whom relief is claimed. However, s.106B is an example of how third parties can be bound by an adverse order in a matrimonial cause. The Full Court has held that (former) s.85 is constitutional, notwithstanding the direct encroachment on the rights of third parties.¹⁷ Thus it has been accepted that s.78 and s.106B (and previously s.85) have authorised orders declaratory of existing rights, or which restore pre-existing rights after a transaction which would defeat a claim, so as to bind third parties.

¹⁷ *Gould & Gould* (1993) 17 Fam LR 156; FLC ¶92-434.

But the new provisions go much further, in authorising the discretionary variation of existing rights. While s.106B is part of the court's armamentarium to protect its undoubted matrimonial causes jurisdiction against attempts to defeat it, the new provisions will have much wider effect. A law conferring on a divorce court power to alter the rights of third parties in this way might well be thought to exceed the bounds of what is reasonably incidental to legislation with respect to matrimonial causes, and thus to be constitutionally invalid.

On the other hand, the drafters of Part VIII A A have been astute to limit the jurisdiction to make orders binding third parties to *in proceedings under s.79*, and *in proceedings under s.114*. In other words, there must first be on foot proceedings between the parties to a marriage for relief under s.79 and/or s.114. Those proceedings are, undoubtedly, a matrimonial cause. It will be argued that ss.90AE and 90AF are laws with respect to matters incidental to matrimonial causes, and it is certainly arguable, but far from clear, that a law which confers power on a court in a matrimonial cause to grant discretionary relief of the type authorised by s.90AE and s.90AF against a third party can be characterised as a law "with respect to matrimonial causes".

Conclusion

The Family Court already has power, to some extent, under s.78, (former) s.85 (now s.106B), and s.114, to bind third parties. The powers hitherto conferred have not so interfered with third party rights as to take them outside the constitutional bounds of matters reasonably incidental to matrimonial causes. New Part VIII A A goes much further, because it authorises discretionary interference with the rights and powers of third parties. It is likely to have wide-ranging impact on the conduct of property proceedings, and result in the proliferation of suits involving third parties, particularly in respect of applications for substitution in respect of debts. The constitutional validity of Part VIII A A is questionable, and it should not be assumed that the new provisions would survive a constitutional challenge, though they may.

Adding Back Notional Property

Two decisions of the Full Court have considered the circumstances in which it is appropriate to add back notional property. The first is *Chorn & Hopkins* [2004] FamCA 633; (2004) FLC ¶93-204. In ascertaining and valuing the joint matrimonial estate, the primary judge included as notional property of the husband a \$28,000 engagement ring which he had purchased for his new partner eight months after separation from the wife, and \$85,000 legal costs paid by the husband to his solicitors. The primary judge also included as notional property of the wife \$36,000 costs paid by the wife to her solicitors. In the appeal, the husband contended that the engagement ring, which had been bought for his partner on credit after separation, ought not have been included, and that if the \$85,000 paid legal costs

were included, so should be the debt which he incurred in order to pay them. In addition, he submitted that account should have been taken of his taxation debts.

The Full Court (Finn, Kay, and May JJ) held that:-

- As the engagement ring was purchased by the husband several months after separation from the wife, and not with funds that existed at or prior to separation but on credit, and in circumstances where funds equivalent to the cost of the ring had been paid to the husband by his new partner, it could not be said that the husband's gift of the ring to his new partner constituted a distribution of matrimonial property, and its value ought not have been brought to account as a notional asset of the husband.
- While the treatment of funds used to pay legal costs was ultimately a matter for the discretion of the primary judge, regard must be had to the source of the funds. If the funds used to pay legal costs existed at separation and were such that both parties could be seen as having an interest in them, then they were to be added back as a notional asset of the party who had the benefit of them. But if they had been generated by a party post separation from his or her own endeavours or received in his or her own right, they would generally not be added back as a notional asset, nor would any borrowing undertaken by a party post separation to pay legal fees be taken into account as a liability in the calculation of the net property. As the primary judge had included the \$85,000 costs paid by the husband in his assets, he should also have included the liability incurred by borrowing to pay at least part of those costs.
- As part of the husband's income earned after his separation from the wife was used to support her and the children, it was just and equitable for his taxation liabilities in respect of that income to be included in his total liabilities.

The second relevant decision is *Omacini & Omacini* [2005] FamCA 195; (2005) 191 FLR 317; 33 Fam LR 134; FLC ¶93-218. The primary judge included in the divisible pool "add backs" of \$439,234 against the husband, and \$57,000 against the wife, including losses from the purchase of shares and investments made by the husband from the proceeds of sale from property owned during the marriage. The trial judge also took into account the possibility that capital gains tax would be incurred by the wife on assets she held. The husband appealed, contending that the add backs should have only included expenditure on legal costs, and that no allowance for CGT should have been made in favour of the wife.

The Full Court (Holden, Warnick and Le Poer Trench JJ) allowed the appeal, holding that:-

- There were three clear categories of case where it was appropriate notionally to add back assets to the divisible pool. The first was where the

parties had expended money on legal costs.¹⁸ The second is where there has been a premature distribution of matrimonial assets.¹⁹ The third is in circumstances discussed by Baker J in *Kowaliw & Kowaliw* (1981) FLC ¶91-092, 76, 644, pertaining to financial losses incurred in the course of a marriage where one of the parties had embarked upon a course of conduct designed to reduce or minimise the effective value or worth of matrimonial assets, or had acted recklessly, negligently or wantonly with matrimonial assets so as to reduce or minimise their value.²⁰

- It was not clear why the trial judge had incorporated some of the add backs in situations not falling with any of those three recognised categories. There was no finding that any of the husband's investment activities were wanton or reckless, whereas to justify an add-back it was necessary to make some assessment of the reasonableness of the husband's expenditures.

Submissions that post-separation expenditure should be added back are common place. Often, particularly in relatively high income cases, a party would argue that expenditure from that income should be added back. These cases make that argument much more difficult to sustain, though ultimately it remains a matter of fact from case to case. They also make clear that whether or not legal costs paid are to be added back depends to a large extent upon whether those costs are funded out of property which existed at separation, or out of income earned since separation.

Nor should it be accepted that assets which existed at separation will necessarily be "added back" if expended post separation. It may be that a party falls on hard times post separation and has to live with capital, rather than income. In such a case injustice might well be done if assets which have been expended in that way are treated as part of the pool.

Punishment for Contempt

In *Abduramoski & Abduramoska*,²¹ the parties separated in December 2003, a month after they had sold their matrimonial home. A few days before separation the husband removed the nett proceeds of sale - some \$234,000 - from their joint account and transferred them to his own account, and subsequently transferred about \$195,000 to various members of his family. About a month after separation the wife obtained interlocutory injunctions restraining the husband from dealing with the proceeds of sale of the home. In contravention of those injunctions the husband retrieved \$180,000 of the funds from members of his family and remitted them overseas to an aunt in Switzerland. Subsequently, orders were made restraining the husband from dealing in any way with the funds transferred to the aunt, except to direct her to return them to the joint account, and a mandatory order that the husband forthwith write to the aunt directing her to return the funds. The wife filed an

¹⁸ As to which see *DJM & JLM* (1998) FLC ¶92-816, 85,262; *Farnell & Farnell* (1996) FLC ¶92-681.

¹⁹ See *Townsend & Townsend* (1995) FLC ¶92-569, 81,654.

²⁰ See *Browne v Green* (1999) FLC ¶92-873, 86,360.

²¹ [2005] FamCA 68; (2005) FLC ¶93-215.

application for contempt alleging that the husband had failed, neglected or refused so to direct the aunt to return the money to the joint account. The primary judge (Penny J) found that the husband intentionally failed to comply with the orders as alleged and that his failure amounted to a flagrant challenge to the authority of the court. Her Honour thought that a fine would not be appropriate as it would only reduce the matrimonial pool, and said that it was important to structure a sentence which would encourage the husband to ensure prompt return of the funds which had been sent to Switzerland and to appropriately punish him both as a deterrent to himself and others who may be tempted to follow his example. The husband was sentenced to a term of imprisonment for 18 months, her Honour noting that she would consider reducing the term should the funds be returned to the joint account.

The husband appealed against the severity of the sentence, arguing that the trial judge had failed to assess relevant sentencing principles, and had determined a sentence outside the range imposed in similar cases.

The Full Court dismissed the appeal, holding that:-

- In dealing with contempts under s.112AP, relevant factors included:-
 - o Part XIII B is a code for dealing with contempt under the *Family Law Act*;
 - o A trial judge must comply with the procedure set out in Rule 21.08 on hearing the application;
 - o The allegation must be proved beyond reasonable doubt;
 - o The procedure is a summary one under the Rules and not a criminal trial;
 - o If a custodial sentence is to be imposed, general criminal law sentencing procedures - including imposing a sentence for each offence to be served either cumulatively or concurrently - may be adopted but that procedure is not mandatory;
 - o State and Federal sentencing laws have no application;
 - o Reference to relevant factors to be considered provides a useful framework but ultimately the penalty should be structured having regard to the individual facts of the particular case.
- There was no error in the trial judge's discretion in imposing a total sentence of 18 months having regard to the fact that the husband's conduct was found to be "a positive course of conduct by the husband designed to ensure that orders made by the Court would have no effect".
- The husband was afforded every opportunity to return the funds and reduce the sentence, and the husband still has the opportunity to reduce his sentence should he return the funds. The sentence was structured with a

strong coercive element.

- The trial judge could have imposed an indefinite sentence.

That invitation was taken up by the same trial judge in the case of *Myers & Myers* [2005] FCWA 52 (Penny J). The Husband contravened an order which restrained him from selling or encumbering a property, by granting security to a third party over the property (which was previously unencumbered, worth \$750,000 out of a pool of \$1.22 million) for borrowings of \$500,000 which were disbursed largely to his girlfriend in Thailand. Her Honour found that this was a deliberate endeavour to ensure that the Wife would not be able to enforce the property order in her favour (since the only remaining asset in Australia of the Husband was a \$60,000 yacht), and committed the Husband to prison until further order, such that the Order was to operate until the Appellant had purged his contempt by making reparation for the damage done by his contempt and paying the associated costs.

The Husband has appealed, contending that her Honour was in error in imposing an order of indefinite committal in circumstances where the relevant contempt was not of an order to do a thing, but rather of an injunction not to do a thing, and it was not practicable for the default to be remedied or the contempt purged, and there was not a reasonable prospect of compliance being achieved by such measure.

Indefinite imprisonment of a contemnor until the contempt has been purged by compliance or the giving of an undertaking to comply may be appropriate *if there is a reasonable prospect of compliance being achieved by such a measure*.²² There can be no reasonable prospect of compliance being achieved by such a measure, where the relevant contempt was not of an order to do a thing, but rather of an injunction *not* to do a thing. That contempt could not be “undone”, or purged. Absent a finding that the contemnor was able to make reparation for the effect of the contempt, and/or that and there was a reasonable prospect of compliance being achieved by an order of indefinite committal, indefinite committal may be inappropriate.

²² *Danchevsky v Danchevsky* [1974] 3 All ER 934, 937; [1974] 3 WLR 709, 712 (Lord Denning MR).