Recent Developments in Property Litigation

(Property settlement orders, trusts and third parties)

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A. Introduction

1. Part VIII of the Family Law Act ("the FLA") grants extensive powers to the Family Court of Australia to make orders adjusting property interests of parties to a marriage under the auspices of "property settlement proceedings". As a consequence of exercising its powers under Part VIII (and also in direct exercise of injunctive powers under Part VIIIAA of the FLA), the Family Court may make orders affecting the interests of third parties (i.e.: persons not parties to proceedings for property settlement orders under section 79 of the FLA). Such third parties may be beneficiaries of a trust; the Commissioner of Taxation; creditors of the parties; and the trustee of a bankrupt spouse's estate under the *Bankruptcy Act* 1966. The capacity to make orders affecting third parties may require the interests of third parties to be taken into account in the formulation of orders and the joinder or intervention of third parties as parties to Part VIII proceedings.

2. The purpose of this paper is to review recent decisions of the High Court and Full Court of the Family Court which considered the approach to third party interests under sections 75(2), 79 and 79A of the FLA. The decisions to be reviewed are as follows:

Kennon v Spry; Spry v Kennon [2008] HCA 56 (3 December 2008) which concerns the issue of setting aside variations of an ante-nuptial Trust designed to put assets in the Trust beyond the reach of the wife and the Family Court.

Commissioner of Taxation & Worsnop and Anor [2009] FamCAFC 4 (16 January 2009) which concerns the issue of whether an "innocent" spouse should bear the burden of a tax liability of which she was not aware despite enjoying the property and lifestyle benefits brought about by non-payment of tax.

Trustee of the property of G Lemnos & Lemnos and Anor [2009] FamCAFC 20 (12 February 2009) - which concerns the issue of whether a spouse may claim for the purposes of section 79 of the FLA the property of a bankrupt spouse that is vested in the trustee in bankruptcy and is otherwise available for unsecured creditors.

Trustee for the bankrupt estate of N Lasic & Lasic [2009] FamCAFC 64 (28 April 2009) – which concerns the issues of whether a trustee in bankruptcy is a person with standing under section 79A of the FLA and whether the Family Court may make an order under section 79 of the FLA for direct payment by a non-bankrupt spouse to an unsecured creditor of a bankrupt spouse.

3. The decisions are of particular importance for those who act for third parties, whether as intervenors or as persons affected by an order under section 79 of the FLA or who seek the variation or setting aside of orders under section 79A.

B. *Kennon v Spry; Spry v Kennon* [2008] HCA 56 (3 December 2008)

4. Dr Spry was a retired member of the Victorian Bar and a Queen's Counsel. In 1968 he created by parol a trust called the ICF Spry trust of which he was the settlor and trustee ("the Trust"). In 1978, he married Mrs Spry. An instrument was

created in 1981 reflecting the terms of the Trust. The beneficiaries of the Trust were Dr Spry and his siblings. By a deed of variation in 1983, Dr Spry was excluded as a beneficiary and he appointed his wife to be trustee on his death of resignation. By a variation created in December 1998 (when the marriage was in trouble), Dr Spry excluded himself and his wife as capital beneficiaries under the Trust. On 30 October 2001, Dr and Mrs Spry separated. In January 2002, Dr Spry established trusts in favour of in favour the four children of the marriage ("the Children's Trusts") and applied to the Children's Trust equally the income and capital of the Trust ("the 18 January 2002 Dispositions"). Dr Spry also conveyed to the children shares held by him beneficially in the Trust. On 20 May 2002, Dr Spry appointed himself and Mr Kennon as joint trustees of each of the four Children's Trusts, such appointment effective from 1 July 2002. The marriage was subject to a decree *nisi* on 17 February 2003.

5. Mrs Spry sought orders in the Family Court for property and maintenance. As part of her application, Mrs Spry sought orders under section 106B of the FLA setting aside the 1998 variation instrument (which excluded Dr Spry and her as capital beneficiaries of the Trust); the instruments creating the Children's Trusts; and the 18 January 2002 Dispositions applying equally to the Children's Trusts the income and capital of the Trust. The children were joined as intervenors. Mrs Spry claimed and the trial judge found she was not told by Dr Spry of the variation of December 1998 which excluded her as a beneficiary of the Trust. The trial judge also found the variation of December 1998 and the 18 January 2002 Dispositions were intended to remove assets of the Trust from the reach of Mrs Spry and the Family Court. The trial judge found the children were innocent victims of their father's endeavors to put assets out of reach but that the children had subsequently attempted to "hold onto assets which they had no direct input in accumulating and which should still be under the control of their parents". The trial judge ordered the variation of December 1998 and the 18 January 2002 Dispositions be set aside. The effect of these orders was to return the assets of the Children's Trust to the Trust and treat the assets of the Trust as property of the

parties of the marriage for the purposes of section 79 of the FLA. Dr Spry was also ordered to pay Mrs Spry $2,182,302.

6. The Full Court of the Family Court dismissed an appeal by Dr Spry and a cross appeal by Dr Spry and Mr Kennon as trustees of the Children's Trust. Appeals to the High Court by Dr Spry and the joint trustee were dismissed. Mrs Spry also brought a cross appeal raising section 85A of the FLA. French CJ, Gummow and Hayne JJ delivered judgment dismissing the appeals by Dr Spy and Mr Kennon as joint trustee of the Children's Trusts and also dismissing the cross appeal by Mrs Spry. Kiefel J delivered judgment dismissing the appeals by Dr Spry and the joint trustee but allowing the cross appeal. Heydon J delivered a dissenting judgment allowing the appeals by Dr Spry and the joint trustee. Due to the weight of decisions dismissing the appeals, the relevant *ratio decidendi* is therefore contained in the judgment of French CJ and the joint judgment of Gummow and Hayne JJ.

7. French CJ reviewed the use of the word "property" and its non-exhaustive definition in section 4(1) of the Act and noted that the word is "indicative and descriptive of every possible interest which the party can have" – citing *In the Marriage of Duff* (1977) 15 ALR 476 at 484. His Honour noted that by the 1983 variation, while Dr Spry was excluded as a beneficiary he remained in possession of the assets of the Trust (as trustee) with legal title to them and to the income which they generated unless and until he should decide to apply capital or income to the beneficiaries.

8. French CJ found at [62] that the Trust assets, coupled with the trustee's powers (prior to the variation of December 1998 excluding Dr Spry and Mrs Spry as beneficiaries) to appoint assets to Mrs Spry and Mrs Spry's equitable right as a beneficiary to due consideration in the administration of the trust, were property of the marriage. But for the variation of December 1998 and the 18 January 2002 Dispositions, the Trust assets would have been available for the purposes of

section 79 of the Act. Further, at [66] French CJ stated that as long as "Dr Spry retained the legal title to the Trust fund coupled with the power to appoint the whole of the fund to his wife and her equitable right, it remained… property" of the parties to the marriage and subject to section 79. Therefore, once the orders were made under section 106B setting aside the variation of December 1998 and the 18 January 2002 Dispositions, the husband's position *qua* the beneficiary and trustee of the Trust was restored. The trust assets and the equitable rights of Mrs Spry to due consideration were then property of the marriage subject to section 79 FLA.

9. French CJ did not address the issue of the application of section 85A of the FLA as raised in Mrs Spry's cross appeal as he felt it unnecessary due to his previous conclusions. As such, he dismissed the cross appeal on section 85A.

10. Gummow and Hayne JJ in their joint judgment at [89] stated that the phrase "with respect to the property of the parties to the marriage or either of them" within the definition of "matrimonial cause" in paragraph (ca) of section 4(1) of the FLA should be "read in a fashion which advances rather than constrains the subject, scope and purpose of the legislation." Further the word "property" was not to be read as a term of art with one specific and precise meaning but should regarded within the statutory context that it appears. At [94], their Honours stated that the reference to the "parties to the marriage" in section 79(1) of the FLA includes a reference to a person who was a party a marriage that has been terminated by divorce at the time the court makes an order under section 79. While at [115] their Honours accepted a proposition that the trial judge erred in treating the assets of the Trust (supplemented by the setting aside of the 18 January 2002 Dispositions) as part of the "asset pool" on the basis that this involved an erroneous assumption Dr Spry could in law apply the assets of the Trust to or for himself, their Honours stated that such an error was not determinative of the appeals.

11. Following review of the 1981 instrument and the 1983 variation (which excluded Dr Spry as a beneficiary), Gummow and Hayne JJ at [125] concluded that Mrs Spry was an eligible benefaction of the Trust in that she was one of a class of objects of a discretionary power to apply income and/or capital vested in the trustee by the Trust. Further, she was one of the class of objects for division of the fund at the "distribution date". As an object of these powers, Mrs Fry had a right in equity to due administration of the Trust. This right in equity to due administration was "property" for the purposes of the FLA. As corollary to this right in equity, Dr Fry as trustee owed her a fiduciary duty.

12. At [128]-[129], their Honours found that as the reference in provisions of the FLA such as section 79 to "the parties to the marriage or either of them" includes a reference to a marriage terminated by divorce prior to hearing of property settlement proceedings, it is within the power of the Family Court to proceed under section 79 as if changes to property rights otherwise brought about by the anterior divorce had not yet occurred (provided that it is just and equitable to proceed in such a manner). This was confirmed as well by section 81 of the FLA which requires final determination of the financial relationship between the parties to the marriage. In light of these findings, their Honours found that it was open to the trial judge to formulate orders on the basis that the asset pool included the assets of the Trust "as supplemented by the operation of the s106B orders". Their Honours stated at [130] that to "proceed on that basis properly reflected what was the "property of the parties to the marriage or either of them" as if the changes to property rights otherwise brought about by the divorce of those parties had not yet occurred". As such, the trial judge did not err in treating the Trust assets as property of the marriage after the section 106B orders were given effect.

13. At paragraph [137], the basis for the decision of Gummow and Hayne JJ was stated in conclusion and is worth quoting as follows:

    The conclusion reached by the trial judge (erroneously) that the husband could have applied the whole or part of the Trust fund to or for *his* own benefit is

> inconclusive of the outcome. The jurisdiction being exercised by the Family Court was, as earlier indicated, jurisdiction over "proceedings between the parties to a marriage *with respect to the property of the parties to the marriage or either of them*" (emphasis added). What matters in this case is that once the 1998 Instrument and the 2002 Instrument were set aside by the s 106B orders, the property of the parties to the marriage or either of them was to be identified as including the right of the wife to due administration of the Trust, accompanied by the fiduciary duty of the husband, as trustee, to consider whether and in what way the power should be exercised. And because, during the marriage, the husband could have appointed the whole of the Trust fund to the wife, the potential enjoyment of the *whole* of that fund was "property of the parties to the marriage or either of them". Furthermore, because the relevant power permitted appointment of the whole of the Trust fund to the wife absolutely, the value of that property was the value of the assets of the Trust. In deciding what orders should be made under ss 79 and 80 of the Act, the value of that property was properly taken into account. Wrongly attributing its value to the husband is irrelevant to the ultimate orders made."

14. As such, the decision of Gummow and Hayne JJ approached the appeals from the perspective that the Trust was to be treated as property of the marriage notwithstanding the fact the parties were divorced prior to the determination by the trial judge. With the section 106B orders validly made, the Trust (including the equitable rights of Mrs Spry as a benefaction) was to be taken into account as the property of the marriage.

15. The practical effect of *Kennon v Spry* (supra) may be summarised as follows:

    1. A trust (including the equitable right to consideration) and its assets may constitute property for the purposes of section 79 of the FLA even when it was established on an ante-nuptial basis, provided that it is just and equitable to do so.

    2. Where variations to the trust are conducted with view to putting the assets of the trust out of the reach of a spouse and the Family Court, section 106B of the FLA may be applied to set aside such variations, notwithstanding their longevity. This may then restore assets to their

original form or status *vis a vis*: the person originally holding title.

3. Orders may be made under section 106B of the FLA even where the children of the marriage are the beneficiaries of the variations to the subject trust, particularly when the children are "innocent victims" of a parent's endeavors to put assets out of reach and in which the children played no role in accumulating.

C. *Commissioner of Taxation & Worsnop and Anor* [2009] FamCAFC 4 (16 January 2009).

16. This is an important decision affecting parties whose spouses have or may have outstanding liabilities to the Commissioner of Taxation.

17. In 1991 or 1992 the parties commenced cohabiting and purported to marry in 1993. This marriage was a nullity as a previous decree *nisi* the wife obtained in England was not absolute. The parties separated in 2005 but not before living a lavish lifestyle and amassing a number of properties. . The matrimonial home had been purchased in June 1999 for $3,450,000. In October 2000 the husband transferred his half interest to the wife for $1.00. The Commissioner of Taxation intervened in Family Court proceedings and sought orders the wife sell the former matrimonial home with the whole of the net proceeds be paid to the Commissioner in partial satisfaction of the husband's tax liabilities.

18. The trial judge declined to treat the husband's personal tax liability as property of the husband and wife and ordered the home be sold with the net proceeds of sale to be divided equally between the Commissioner and the wife. In judgment, the trial judge accepted the wife's evidence that she did not know or ought to have known of the husband's non-disclosure of income or funds for tax purposes. As

such, the trial judge found the wife did not know or ought to have known the husband failed to meet his tax obligations.

19. The Commissioner raised numerous issues on appeal, some of which are not relevant to this paper. However, the first (and most relevant) was that the trial judge should have found that the source of funds for the acquisition of real property by the husband and wife (including the matrimonial home) was income upon which tax had not been paid. The Full Court had regard to cross examination of the wife inn which she stated that she believed monies to purchase properties came from "the business" and never questioned where the money came from. The trial judge at [225] of his decision found that the "wife unwittingly continued to have the benefits of a lifestyle which for some years was enhanced by the failure of the husband to disclose taxable income".

20. The Full Court at [38]-[39] observed firstly that the issue of the source of the income was separate to the wife's knowledge of any claim upon the funds by the Commissioner. Secondly, the factual issue of to what extent the source of funds for the purchase of the real property was unpaid tax or income upon which tax should have been paid was one on which no precise findings could be made. As such, given these two conclusions, the trial judge did not err by recognizing the "broad' facts relating to the purchase of real estate rather than conducting a close analysis of the evidence relating to the purchases.

21. The second relevant issue raised on appeal by the Commissioner was addressed to the general constructions of section 79 of the FLA. In essence, the Commissioner submitted that the Family Court should make orders for property settlement out of the net property. Further to this, the Family Court should consider the use to which the funds were put and the benefits received by the parties. A party who has received (knowingly or not) the benefit of money or property available as a result of their partner's dishonesty should share equally any debt thereby created. The Family Court cannot ignore the contribution to acquisition of assets and

lifestyle made by a creditor. In making these submissions, the Commissioner relied on, *inter alia*, *Biltoft and Biltoft* (1995) FLC 92-614 (which states that while a creditor has rights under section 79 of the FLA which must be recognised and balanced against the rights of a spouse, there is no priority between a claimant creditor and spouse) and *Kowaliw and Kowaliw* (1981) FLC 91-092 (which refers to wastage of assets due to a party acting recklessly, negligently or wantonly with respect to those assets).

22. With respect to the Commissioner's submissions that, cumulatively, the party who has had the benefit of funds from a creditor (even if unknowingly) should share the burden of the debt, the Full Court at [61] – [63] rejected these as being expressed in mandatory and inflexible terms. Notwithstanding this, the Full Court did state at [63] that "it is highly unlikely that the use to which funds were put and the benefits received by each party from those funds would not be an insignificant factor when addressing the position of an unsecured creditor, whose prospects of recovery of debt are uncertain". As practitioners are no doubt aware, section 75(2)(ha) of the FLA requires the court to take into account for the purposes of section 79 the effect of any proposed order on the ability of a creditor of a party to recover the creditor's debt. This necessarily requires the Family Court to take into account the nature and source of the claim by the creditor and the benefit obtained by the parties from the creditor.

23. With respect to the submission that an innocent party should share the full burden of the debt, the Full Court rejected this as a mandatory statement at [64] but reiterated the decision of *Johnson and Johnson* [1999] FamCA 369 in which it was held that the fact a wife was involved in a tax avoidance process which may lead to imposition of penalties was a factor relevant (but not determinative) of the exercise of the discretion under section 79 FLA. The Full Court stated at [70] of the issue of knowledge as follows:

> "In our view, though as we said a short time ago, the question of innocence or ignorance in a spouse of the other spouse's tax avoidance may carry more weight in respect of penalties, we see no reason why that question might not also be relevant to the issue of unpaid prime tax, even if the "innocent spouse" has received benefit from the failure to pay tax."

24. The Full Court finally considered the submission that to achieve justice and equity for all, including a creditor, the court must consider making an adjustment pursuant to section 75(2)(ha) of the FLA to benefit the creditor. This submission was noted with some concern as it may, if accepted, have the effect of giving an unsecured creditor some status otherwise not available at law. The Full Court stated, in rejecting the submission, at [78] - [79] that while it is well established that under section 79 of the FLA the Family Court may make orders for the payment by a spouse or spouses of a debt to a third party, the order should not be made unless it is just and equitable to do so by reference to section 79(1) of the FLA. Section 79(1)(a) in particular refers to the interests of the parties to the marriage in the property. The court rejected any imputation that a creditor may obtain some equity or advantage under section 79(2) of the FLA by stating at [78] as follows:

> "Altering the interests of the parties to the marriage in the property does not mean that an intervening third party creditor acquires by intervention some rights based on s79(2) for a just and equitable remedy, that are additional to the other creditor's rights at law."

25. In conclusion, the Full Court found at [84] that the trial judge "appreciated the critical features" of the exercise he was called upon to carry out, being the balancing of the claims of the wife against those of the Commissioner. The trial judge noted (and the Full Court accepted) that in the period the husband failed to meet his tax obligations, the wife continued to make significant contributions by raising four children and was also innocent of and not complicit in the tax evasion. She was in fact denied the choices she could have made had she been aware of the evasion (presumably making the husband pay tax). Balanced against this was the position of the Commissioner as a non-commercial creditor whose

claim arose as a result of the affairs of the tax payer and over which there was a public interest issue. As found by the trial judge (and accepted by the Full Court), the competing claims were balanced by depriving the wife of some entitlement to which she would have otherwise been entitled.

26. The effect of this decision may be summarised as follows:

    1. Where an unpaid debt to the Commissioner is in existence, the non-liable spouse is not automatically obliged to suffer the burden of the debt especially where he or she is "innocent" in the sense he or she was ignorant of and non-complicit in the debt.

    2. The Commissioner, despite public interest considerations, is not entitled, even as an intervenor, to automatic considerations of justice and equity under section 79(2) of the FLA. Instead, the Commissioner's interests must be balanced against those of the "innocent spouse".

    3. The interests of the Commissioner may be taken into account by reducing the entitlement of the innocent spouse by depriving that spouse of some entitlement to which he or she would otherwise be entitled.

D. *Trustee of the property of G Lemnos & Lemnos and Anor* [2009] FamCAFC 20 (12 February 2009)

27. The matter of *Lemnos* was an appeal by the trustee of the bankrupt estate of the husband against orders made by the trial judge in proceedings under section 79 of the FLA. The husband was a solicitor with a high income and the wife earned distributions from a family trust. The primary source of income of the trust was the husband's legal practice. The parties married in 1976 and separated in 2007. In 1981, the parties jointly purchased a property called ""B". In 1989, the husband purchased a property called "W" for $1,300,000 and used the B property as

security on W. The wife was also a guarantor of the finance for W. The parties held a joint account into which the income of both parties was deposited. Loan repayments on the W and B properties were made from that joint account. As at the trial date, W was valued at $4,500,000 - $5,000,000 and was encumbered for $2,415,000.

28. In 2002, the husband was investigated by the ATO for the period 1991 – 2002 and was found to have impermissibly claimed deductions for the W and B properties of $3,396,333. He was reassessed as having a tax liability of not less than $5,700,000 as at the trial date. Interest accrual meant the sum was greater by judgment date. The husband was the subject of a sequestration order on 17 November 2006. The parties separated on 4 July 2007. In judgment, the trial judge ordered that the property vested in the trustee be sold, and the net proceeds of the sale after payment of sale expenses and the discharge of the mortgage be divided equally between the trustee and the wife. The trial judge found the husband was reckless and negligent in the filing of his tax returns which was an action without the consent or knowledge of the wife. As such, and given the principles of a party bearing responsibility for wastage of assets as per *Kowaliw and Kowaliw* (1981) FLC 91-092, the husband should satisfy the ATO debt from his own resources. The trustee had submitted at trial that all property should be vested in the trustee. The trustee appealed and sought an order, inter alia, that a lump sum be provable in the estate of the husband by the wife.

29. In the appeal, Coleman J delivered a judgment which provides a very useful analysis of the effects of amendments to the FLA and the *Bankruptcy Act* 1966 (Cth) ("the BA") enacted by the *Bankruptcy and Family Law Legislation Amendment Act* 2005 (No. 20 of 2005, date of assent 18 March 2005, commencement 18 March 2005 and 15 April 2005) ("the amending Act"). This analysis was agreed with by the majority judgment of Thackray and Ryan JJ. It is the interpretation by Coleman J and the conclusions as to the powers of the

Family Court to make orders in respect of property vested in a trustee in bankruptcy that are of interest and the focus of this paper.

30. Coleman J noted that section 79(1)(b) empowers the Family Court to make orders in property settlement proceedings altering the interests of the trustee in bankruptcy where a party is bankrupt. In making orders under section 79(1), the Court must take into account the matters listed in section 79(4) of the FLA. These include considering the matters under section 75(2) of the FLA. Section 75(2)(ha) requires the Court to take into account the effect of any proposed order on the ability of a creditor of a party to recover the creditor's debt, so far as that effect is relevant. Coleman J then referred to section 58 of the BA which has the effect of vesting property and devolving after-acquired property of a bankrupt in the Official Trustee or the registered trustee. Section 116(1) of the BA sets out the property that is divisible amongst creditors of the bankrupt. Section 116(2)(q) of the BA (inserted by the amending Act) provides a specific exclusion to section 116 for property that the trustee is required to transfer to the spouse of the bankrupt pursuant to an order under Part VIII of the FLA.

31. In reconciling the powers of the Family Court to make orders with respect to property vested or devolved in the trustee in bankruptcy in accordance with the BA, Coleman J had reference to the Second Reading speech of the amending Act which stated that the amendments:

> "will enable concurrent bankruptcy and family law proceedings to be brought together in a court exercising family law jurisdiction, to ensure that all issues are dealt with at the same time…The effect of these amendments will be to offer procedures and protections to the non-bankrupt spouse that were not previously available. At the same time, the court can be on notice about the interests of creditors of a bankrupt spouse and can take those interests into account in determining family property or spousal maintenance orders."

32. Coleman J found at [57] that the language of the amendments to the FLA and the BA by the amending Act and the Second Reading speech revealed an intention that the rights of unsecured creditors of a bankrupt spouse to a share of the

bankrupt's property "were no longer to be automatically preferred to the property settlement rights of the non-bankrupt spouse". At [58], following reference to concessions by trustee, Coleman J stated that there was no suggestion that the interests of unsecured creditors of the bankrupt or non-bankrupt spouse be afforded any particular weight. At [59], Coleman J stated that the 2005 amendments were intended to avoid the situation where a non-bankrupt spouse could only make a section 79 claim against non vested property and whatever property might remain after the completion of the bankruptcy. Property to which the non-bankrupt spouse was "determined to be entitled pursuant to the provisions of the FLA no longer vested in the trustee in bankruptcy for the benefit of creditors of the bankrupt's estate".

33. In reaching this conclusion, Coleman J disagreed with a commentary by now Federal Magistrate Dr Tom Altobelli that the interests of creditors of the bankrupt will be "subsumed to the needs of children and spouses." At [61], Coleman J held that the reconciliation of the conflicting rights of unsecured creditors of the bankrupt spouse and the rights of the bankrupt's spouse involves the exercise of the discretion contained within the FLA.

34. This view was confirmed later in Coleman's judgment when he rejected an argument by the trustee that, due to the vesting of property on sequestration, there was no "property" for which property settlement orders could be made. Coleman J stated at [97] that the effect of the amending Act was that the Family Court has jurisdiction to make orders which have an adverse effect on unsecured creditors. This is because the definition of "property" in the section 4 definition of matrimonial cause is not limited to net property available after creditors are paid. Instead, "property" includes property vested in the trustee of a bankrupt spouse. Further, Coleman J stated at [99] that the effect of the insertion of section 79(1)(b) of the FLA by the amending Act is that the interests of unsecured creditors do not "trump" the interests of the non-bankrupt spouse. The FLA now requires the Family Court to balance the competing claims of spouses and creditors (including

unsecured creditors of bankrupt spouses) in the exercise of the discretion under section 79 of the FLA.

35. Ultimately, Coleman J found at [175]-[176] that the trial judge erred by finding the ATO debt should be funded solely by the husband before having regard to the factor in section 75(2)(ha) of the FLA (which refers to the effect of any proposed order on creditors).

36. Thackeray and Ryan JJ allowed the appeal although for slightly different reasons. Importantly, at [200], the joint judgment stated that the effect of the amending Act is that the interests of unsecured creditors do not automatically prevail over the interests of the non-bankrupt spouse and that the "legislation requires the Court to balance their competing claims in the exercise of the wide discretion conferred by s79".

37. As such, there is a clear *ratio decidendi* in Lemnos as to the effect and operation of section 79 and 75(2) on property vested in a bankrupt trustee i.e.: such property is available as part of the pool of property for consideration under section 79(1) without the unsecured creditors obtaining some preference over the position of the non-bankrupt spouse. This view was confirmed by the joint judgment of Thackeray and Ryan JJ at [272] in a passage that is worth citing in its entirety:

> "Had Parliament intended to treat the entitlement of the non–bankrupt spouse as if it were a debt provable in the bankruptcy, it could have so provided when enacting the 2005 amendments, for example by expanding the scope of s 82(1A) of the BA to include obligations pursuant to orders made after the date of bankruptcy in proceedings under the FLA between the trustee in bankruptcy and the non–bankrupt spouse. Parliament instead elected to enact s 116(2)(q) of the BA, which removes from the property available for distribution between creditors any property that the trustee is required to transfer to the spouse of the bankrupt under s 79 of the FLA. In so doing, Parliament ensured that there was no inconsistency between the operation of the FLA and the BA."

E. *Trustee for the bankruptcy estate of N Lasic & Lasic* [2009] FamCAFC 64 (28 April 2009)

38. In the matter of *Lasic*, the issue for consideration on appeal was the standing of a trustee in bankruptcy as an applicant in proceedings under section 79A of the FLA (which permits the Family Court to set aside an order under section 79 of the FLA).

39. The husband and wife married in 1968. They owned a number of properties. On 29 March 1994, their son shot and injured a third person, Mr M, at the matrimonial home. Mr M commenced proceedings in 1996 in the District Court of NSW in for damages against the husband, the wife and the son. On 22 December 1997, the husband and wife filed a joint application for dissolution of the marriage. On 2 April 1998, consent orders were made in the Family Court for the transfer of real property interests held by the husband to the wife. On 26 June 1998, Patten DCJ entered judgment in the District Court of NSW against the husband, wife and son. On appeal, the NSW Court of Appeal overturned the judgment against the wife but upheld the judgment against the husband and son. On 30 June 2000, a sequestration order was made against the husband. The judgment debt in respect of Mr M was $470,914.44. Mr M proved for the judgment debt as an unsecured creditor in the bankruptcy of the husband.

40. The wife later received compensation totaling $2,331,932.47 from the NSW Roads and Traffic Authority in respect of resumed property. The trustee of the husband's estate commenced proceedings in the Family Court under section 79A of the FLA seeking orders the consent orders of 2 April 1998 transferring the husband's real property interests to the wife be set aside. The wife admitted at trial in the Family Court that she had net assets worth $2,548,862 and superannuation of about $1,000,000. After the trial but before the delivery of judgment the husband died. In the course of the trial the wife conceded the intention of the consent orders of 2 April 1998 was to avoid any liability that the husband may have had to Mr M due to the proceedings in the District Court. This

intention coupled with a failure to disclose the District Court proceedings, it was conceded, enlivened the discretion under section 79A of the FLA.

41. The trial judge noted that the effect of the trustee's application was that the property of the wife would be divided equally between the trustee and the wife. The trustee was therefore seeking between $900,000 and $1.8 million (based on a value of the wife's property of approximately $3.6 million). The trial Judge also noted that the bulk of any property that would be awarded to the trustee would be used to satisfy the trustee's costs and disbursements and ultimately no monies would be payable to Mr M.

42. The trial judge ordered that a payment be made by the wife to Mr M of $319,081.38 and that the consent orders of 2 April 1998 be amended to so provide. The trial judge noted that if the proposed orders sought by the trustee were made and Mr M were to receive nothing, such an outcome would "be offensive to notions of justice and equity". The trial Judge was satisfied that an order for payment to Mr M was an order able to be made within the framework of section 79 of the FLA. The trustee appealed.

43. On appeal, Boland, Thackray and Ryan JJ had cause to further consider the *Bankruptcy and Family Law Legislation Amendment Act* 2005 ("the amending Act") as it amended section 79A(1) of the FLA by replacing the words "proceedings with respect to property of the parties to a marriage" with the words "property settlement proceedings". The amending Act also inserted section 75A(5) of the FLA which provides that if an order is made under section 79 of the FLA and a party at the time of the order is bankrupt or becomes bankrupt afterwards, the bankruptcy trustee is taken to be a person whose interests are affected by the order. It was conceded by the parties on the appeal that, due to the non-retrospective effect of the amendments, section 79A(5) of the FLA did not apply as the husband's bankruptcy predated the amending Act. However, on review of the authorities, the Full Court held at [164] that a trustee in bankruptcy

is a person affected by an order made by the Family Court under section 79 prior to the amending Act such as to have standing under section 79A.

44. The next issue was whether the order of the trial judge that payment be made directly to Mr M could stand. The Full Court held it could not. The Full Court had regard to the provisions of both the FLA and the BA, in particular sections 58 and 109 of the BA. Section 58 of the BA provides that all property vests in the trustee on bankruptcy while section 109 of the BA specifies the priority in which debts of the bankrupt estate are to be satisfied from available proceeds. Unsecured creditors (such as Mr M) rank behind the trustee's entitlement to reimbursement of expenses. The trustee in the appeal submitted that in making the orders for payment of Mr M, the trial Judge ignored section 58 and 109 of the FLA.

45. At [200] the Full Court, on review of case law as to the capacity to pay creditors of parties, confirmed that, subject to the provisions of the BA, the trial judge could have ordered the wife to pay a creditor of the parties provided any affected third party had notice and the orders were "just and equitable". The question then became whether Mr M was a "creditor" of the husband. The Full Court found at [203] – [207] that due to the sequestration order and the effects of the BA, Mr M's rights of recovery (as with the rights of all creditors of the husband) were governed by section 109 of the BA. As Mr M had proved in the bankruptcy as an unsecured creditor, under section 58(3)(a) of the BA he could not independently enforce his judgment or receive payment of the judgment debt. At [209], the Full Court concluded the trial Judge erred in making an order that payment be made to Mr M by the wife as the order was not within his Honour's power.

46. It is apparent that the trial judge attempted to overcome a perceived unfairness in the application of sections 58 and 109 of the FLA. It is also apparent from the Full Court's decision, however, that the Family Court cannot exercise its wide discretion under section 79 of the FLA such as to ignore the fact that unsecured creditors of a bankrupt spouse can only seek satisfaction of their claim under

section 109 of the BA. If the Family Court makes orders for a direct payment to an unsecured creditor of a bankrupt spouse, such an order is beyond power and liable to be set aside. Therefore, to comply with the BA, any orders under section 79 would need to be structured such that, after recognizing the rights of the non-bankrupt spouse and secured creditors, the net assets of the bankrupt spouse vest in the trustee such that no payment may be made directly to an unsecured creditor of the bankrupt spouse.

F. Conclusion

47. The foregoing case analyses (it is hoped) have provided some guidance to recent decisions impacting on the difficult area of property settlement proceedings under section 79 of the FLA and the interrelationship of that section with trusts and third party interests.

48. It should be borne in mind that in Part VIII proceedings, third parties including the Commissioner for Taxation and trustees in bankruptcy may have standing to appear and their interests are be taken into account by the Family Court when dealing with "property of the parties to the marriage" as defined by the matrimonial cause definition in section 4 of the FLA.

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