

Financial Agreements

Outline of Chapter

- 6.1 This chapter of the report addresses the amendments proposed in schedules 4 and 5 of the draft Bill. The amendments in both schedules are concerned with family law financial agreements. The following issues are addressed in relation to the schedule 4 proposed amendments:
- Support for the proposed change.
 - Criticism of the proposed change.
 - The Committee's concerns.
- 6.2 The following issues are addressed in relation to the schedule 5 proposed amendments:
- Support for the proposed change.
 - Criticism of the proposed change.
- 6.3 The Committee makes one recommendation encompassing both proposed amendments.

Proposed Amendment Relating to Claw Back Provisions

Background

- 6.4 Schedule 4 of the draft Bill contains proposed amendments in relation to family law financial agreements. As noted in Chapter 2, Schedule 4 proposes to amend the definition of ‘maintenance agreement’ at subsection 5(1) of the Act to exclude financial agreements entered into under Part VIIIA of the *Family Law Act 1975*. This will allow the trustee to use the Act’s clawback provisions (contained in Division 3 of Part VI) to recover property transferred by the bankrupt prior to the commencement of the bankruptcy.¹
- 6.5 The Explanatory Memorandum for the draft Bill explained the reasons for this proposed change:

Division 3 of Part VI includes provisions which allow trustees to recover certain property transferred by the bankrupt prior to the commencement of his or her bankruptcy. These provisions do not apply to transactions arising from the bankrupt’s liability under a ‘maintenance agreement’ or ‘maintenance order’. A financial agreement made under Part VIIIA of the Family Law Act is a ‘maintenance agreement’ for the purposes of the Act.

A financial agreement can be made before or during the marriage or following separation. It is a binding agreement dealing with the distribution of property in the event of the marriage breaking down. It may also provide for the maintenance of either party to the marriage or their children. Financial agreements do not require approval by a court. Nor do they have to be registered with the court. They can only be set aside by the court in circumstances similar to those applying in contract law (such a fraud and undue influence). For these reasons, it is not appropriate that property transferred pursuant to such an agreement is excluded from the property available to pay creditors.²

1 BLAAAMB 2004, Explanatory Memorandum, p.36.

2 BLAAAMB 2004, Explanatory Memorandum, p.36

Support for the Proposed Change

- 6.6 The FLS of the LCA expressed support for an amendment that would remove financial agreements from the definition of maintenance agreement in the Act, noting that ‘They (financial agreements) are undeniably a way of settling property. I am sure the only reason that they were ever there in the definition is that once upon a time there were section 87 maintenance agreements and they were abolished’.³

Criticism of the Proposed Change

- 6.7 There was no evidence put before the Committee expressing criticism of the proposed change.

Amendment Providing for a New Act of Bankruptcy

Background

- 6.8 Schedule 5 of the draft Bill also deals with family law financial agreements. The amendment proposes to introduce a new act of bankruptcy in proposed paragraph 40(1)(o) of the Act which will occur when a person is rendered insolvent as result of assets being transferred pursuant to a financial agreement under the *Family Law Act 1975*. The effect of this proposed amendment will be that the trustee is able to claim the property transferred under the relevant financial agreement as divisible property in the bankrupt estate. The Explanatory Memorandum for the draft Bill described the proposed amendment:

The new act of bankruptcy will apply only where the transfer under the financial agreement has the effect of rendering the person insolvent. This would apply only to transfers pursuant to financial agreements and not to other property distributions (for example, property settlements under section 79 of the Family Law Act).

Subsection 115(1) of the Act provides that the bankruptcy of a person shall relate back to, and be deemed to have commenced at, the time of the commission of the earliest act of bankruptcy within a period of six months before the

3 The FLS of the LCA, *Transcript of Evidence*, 6 July 2004, p.91.

presentation of the petition leading to the person's bankruptcy. This amendment will allow the trustee to claim the property transferred pursuant to the financial agreement as divisible property in the estate.

Item 2 proposes to insert new subsection 40(7A) which makes it clear that, for the purposes of paragraph 40(1)(o), a transfer of property includes a payment of money and that a person who does something that results in another person becoming the owner of property that did not previously exist is taken to have transferred the property to that other person.⁴

Support for the Proposed Change

- 6.9 The IRC of the LCA supported the proposed change, suggesting that such a provision would most likely have the effect of a trustee being appointed earlier than might otherwise be the case.⁵ This submitter also expressed concern however that there might be difficulty in establishing the act of bankruptcy.⁶
- 6.10 The FLS of the LCA also expressed (in broad terms) support for the proposal.⁷

Criticism of the Proposed Change

- 6.11 As noted above, the IRC of the LCA suggested that, given there is no requirement in relation to registration of a financial agreement, there may be difficulty in establishing the relevant act of bankruptcy:

On balance, I prefer to see it (the proposed new act of bankruptcy) there, but the reality is that it is a private agreement between two individuals, unless it is made public...Given that it is a private arrangement, how are you going to prove it?⁸

4 BLAAAMB 2004, Explanatory Memorandum, p.37.

5 The IRC of the LCA, *Submission 98*, p.34.

6 The IRC of the LCA, *Submission 98*, p.34

7 The FLS of the LCA, *Submission 98*, p.1.

8 The IRC of the LCA, *Transcript of Evidence*, 6 July 2004, p.82.

The Committee's Concerns

- 6.12 The Committee has some concerns in relation to the amendment proposed in Schedule 4 of the draft Bill. ITSA noted that, by removing financial agreements from the definition of 'maintenance agreement' in the Act, this amendment would 'allow the trustee to recover property transferred at less than market value or as a preferred transfer to a creditor where that transfer occurred pursuant to the terms of the financial agreement.'⁹
- 6.13 However, it is the Committee's view that such an amendment may have a detrimental impact on those financial agreements involving a transfer of an asset in lieu of maintenance. In that situation, there is a potential for families to be disadvantaged where the trustee is able to recover an asset that has been transferred for the benefit of the family.¹⁰ Moreover, the spouse would be placed in the position of having to appear before the court to defend the trustee's action, which would involve further cost to that party. While ITSA's evidence was that such a situation would not 'necessarily follow',¹¹ the Committee has reservations in relation to this as a potential outcome.

Conclusion

- 6.14 The Committee concludes that the amendments proposed in schedules 4 and 5 should be implemented.

Recommendation 6

- 6.15 **The Committee recommends that the amendments proposed in Schedules 4 and 5 of the draft Bankruptcy Legislation Amendment (Anti-Avoidance and Other Measures) Bill 2004 be implemented.**

Hon Bronwyn Bishop MP
Chairman
July 2004

9 ITSA, *Transcript of Evidence*, 6 July 2004, p.4.

10 *Transcript of Evidence*, 6 July 2004, p.4.

11 *Transcript of Evidence*, 6 July 2004, p.4.