RAPSEYGRIFFITHS

TURNAROUND + INSOLVENCY

FAMILY LAW

BANKRUPTCY, INSOLVENCY & SECTION 66G

A comprehensive guide for family lawyers.

Contents

This e-book is designed to help family lawyers understand the complex areas of bankruptcy and corporate insolvency in family law proceedings and the role of Section 66G of the Conveyancing Act 1919.

INTRODUCTION

Family court proceedings are a complicated beast at the best of times. Disputing parties are often in conflict and concerned with their own interests and getting what they believe they are entitled to – whether that's money, access to children or both.

When one of the parties in a separating couple is facing or has already entered bankruptcy, or the couple are co-owners of a business – with or without solvency issues – the beast can grow more complicated still as money and security become increasingly uncertain.

Will the non-bankrupt party or dependants lose out? Who will get the business? Should the business be wound up? How are decisions over property and other assets made? These are just some of the common questions that arise in these types of cases.

While the Family Law Amendment Act 2005 was designed to clarify the interaction between family law and bankruptcy, the interaction between family law and corporate insolvency is less clear cut.

Also coming into play is section 66G of the Conveyancing Act 1919 (NSW). This deals with settling matters of co-owned real property, offering sale or partition as a solution.

To make dealing with bankruptcy and insolvency within family court proceedings easier, we've delved into the ins and outs of the laws as they cross over to create a comprehensive guide for you to refer to.

27,058

No. of new personal insolvencies in Australia 2018-19

15,329

No. of new bankruptcies in Australia in 2018-19

8,105

No. of companies that external administration administration in 2018-19 (Australia-Wide)

2,729

No. of companies that entered external administration in 2018-19

CHAPTER 1
LEGISLATIVE DEFINITIONS

Legislation included

The Bankruptcy Act 1966 | The Conveyancing Act 1919
The Corporations Act 2001 | The Family Law Amendment Act 2005

BANKRUPT

An individual who has entered into bankruptcy.

BANKRUPTCY

Bankruptcy is a legal process where a person is declared unable to pay their debts and released from them so the bankrupt can start financially afresh. It is governed by the Bankruptcy Act 1966 and regulated by the Australian Financial Security Authority (AFSA).

INSOLVENCY

Insolvency is the state of being insolvent or unable to pay your debts as and when they are due and payable. It falls under **section 95A of the Corporations Act 2001** and **section 5 of the Bankruptcy Act 1966.**

LIQUIDATION

Liquidation is the process of closing a business so that its assets can be sold to pay off its debts. It's also referred to as the winding up and finalising of a company's affairs, and it's conducted under the Corporations Act.

SECTION 66G

Section 66G is a provision in the Conveyancing Act NSW regarding property held in co-ownership.

PLEASE NOTE: The Family Law Act applies to different types of personal relationships (e.g. spousal, de facto). For ease of reference, we have adopted the term 'parties' throughout this e-book.

Section 95A of the Corporations Act 2001

(1) A person is solvent if, and only if, the person is able to pay all the person's debts, as and when they become due and payable. (2) A person who is not solvent is insolvent.

Section 5 of the Bankruptcy Act 1966

(1) A person is solvent if, and only if, the person is able to pay all the person's debts, as and when they become due and payable. (2) A person who is not solvent is insolvent .

CHAPTER 2
BANKRUPTCY & FAMILY LAW

If a person in a marriage or de facto relationship is declared bankrupt, it can have a significant impact on family law disputes. But what are the basics of family law and bankruptcy? And how can they be effectively mutually applied?

FAMILY LAW AMENDMENT ACT 2005

The Family Law Amendment Act 2005 was designed to clarify the interaction between the Family Law Act 1975 (FLA) and the Bankruptcy Act 1966.

The amendments were also designed to give the Family Court the ability to deal with matters of bankruptcy at the same time as matters under the FLA.

THE BANKRUPTCY ACT 1966: THE BASICS

When a person is declared bankrupt, their assets are handed over to the control of a trustee.

This means they no longer have control over them. They're also unable to transfer property in accordance with any order for property settlements made in family law proceedings.

WHAT IS A TRUSTEE?

A trustee is the person or entity that manages a bankruptcy, working with the bankrupt, and their creditors. During bankruptcy, a bankrupt is obliged to provide information to the trustee, including books, bank statements and any changes to their circumstances – AFSA.

In any family law proceedings involving a division of matrimonial assets, the trustee must be joined as a party according to the rules set our in the Family Law Act 1975. Importantly, when a party is declared bankrupt, there's no obligation to comply with pre-action procedures in family law, such as mediation.

THE POWERS OF FAMILY COURT

As a result of the FLA Amendment Act, the Bankruptcy Act now gives the Family Court the power to deal with any matters connected to or arising out of bankruptcy in a marriage or de facto relationship in the following proceedings:

- Property settlement under Section 79 or 90SM
- Declaration of interest in property under Section 78 or 90SL
- Setting aside property orders under Section 79A or 90SN
- Spousal maintenance under Section 74
- Maintenance (in relation to a de facto relationship) under Section 90SE
- Enforcement of any of the above orders

PROPERTY SETTLEMENTS

PROTECTION FOR THE NON-BANKRUPT SPOUSE

The Section 79 amendment expanded the definition of 'matrimonial cause' to include proceedings between a party and the trustee in bankruptcy and the property vested with the trustee.

This means the bankruptcy trustee can be ordered to settle or transfer what would otherwise have been bankruptcy property to the non-bankrupt party or child of a marriage. In other words, the non-bankrupt party and any dependents are protected from the effects of bankruptcy of the other party.

RIGHTS AND RESTRICTIONS UNDER SECTION 79

BANKRUPT PARTY

Unless the court gives permission, the bankrupt isn't allowed to make any submissions in relation to property issues because the power over that property is vested in the trustee and not the bankrupt. However, they do have the right to make submissions about property not under the authority of the trustee, such as an interest in superannuation.

NON-BANKRUPT PARTY

The non-bankrupt party has the right to make an application for an injunction against the bankrupt party. An injunction can stop the trustee from declaring or distributing any assets or property among the bankrupt's creditors before the property settlement has been resolved.

PERSONAL INSOLVENCY AGREEMENTS (PIAs)

Not all financial struggles result in bankruptcy. In some cases, an individual involved in family law proceedings may have entered or enter into a personal insolvency agreement (PIA). A PIA is an arrangement to settle debts without becoming bankrupt.

Contact Rapsey Griffiths for more details about how PIAs can work in the context of family law proceedings.

1300 727 739 | enquiries@rgia.com.au

GIVING NOTICE OF BANKRUPTCY

A bankrupt or person who becomes bankrupt (or has entered into a PIA) and is a party to Family Court proceedings must notify the court at the start of the proceedings or as soon as they have entered bankruptcy.

DISPUTES OVER THE FAMILY HOME

When a person is declared bankrupt, their home isn't a protected asset under the Bankruptcy Act 1966. As soon as bankruptcy is declared, authority for the bankrupt's share of property is immediately handed over to the trustee. The trustee is then legally obliged to realise any equity in the property after paying the mortgage and selling costs.

In the case of family law disputes when the property is co-owned by parties (in a marriage or de facto relationships), and a trustee takes control, joint tenancy is automatically severed.

The interests in the property are then held as 'tenants in common' between the non-bankrupt party and the trustee of the bankrupt.

Although the property is jointly owned, the trustee must still realise the bankrupt's share. While they can insist on selling the home, they will usually attempt to work with co-owners to come to a mutual agreement on the sale of the property.

There are several ways in which jointly owned property can be treated during bankruptcy. How it's treated depends on the value of equity in the property as follows:

- **OWNED OUTRIGHT BY THE BANKRUPT WITH NO MORTGAGE** – The trustee will work to sell the property at fair market value.
- **JOINTLY OWNED WITH NO MORTGAGE** – The trustee will give the co-owner the chance to buy the bankrupt's share. If this isn't possible or agreed, they will seek agreement from both parties for sale. Where an agreement isn't reached, the court may grant a 'statutory trustee for sale' over the co-owner's share to allow the sale. The proceeds of the sale will then be shared equally between the trustee and co-owner– subject to any final adjustment as part of a property settlement.
- **JOINTLY OWNED WITH MINIMAL EQUITY** – The trustee will have the property valued and deduct the value of the mortgage to determine the estimated equity. The trustee can then offer the co-owner the chance to buy the bankrupt's share of equity and the co-owner will continue with the refinanced mortgage.
- **JOINTLY OWNED BUT WITH NO EQUITY** – Where the equity value of a property is nil due to loans secured against it, the trustee may offer the co-owner the chance to buy the future rights for a nominal fee. In this scenario, the co-owner must continue to service the mortgage. There's a small risk that the mortgagee would take possession of the property. However, if the mortgage can be maintained, it would be unlikely that the mortgagee would take recovery action.

50/50 EXONERATION

If a house is jointly owned, but one of the parties has used the property for security for a business venture for their own benefit only, they have to pay the loan secured against it from their portion of the jointly-owned property.

DETERMINING PROPERTY SETTLEMENTS

In all family law cases that involve bankruptcy, it's down to the court to determine the competing rights of the non-bankrupt and creditors and to decide who gets what. To do this, the court must apply the following five-step process:

1. Identify each of the parties' legal and equitable interests in property and superannuation
2. Decide if it's fair and reasonable to make an order altering existing interests
3. Consider financial and non-financial contributions to property and family welfare
4. Consider the specific needs and characteristics of each of the parties
5. Determine that the order to be made is just and equitable

Once determined, the court also has the power to order the trustee to act on this.

CHILD SUPPORT AND SPOUSE MAINTENANCE

Even if a person is declared bankrupt, child support or spousal maintenance orders can still be made against them. When an order is made, the payments are viewed as a debt of the bankrupt party. It's then up to the non-bankrupt party to decide if they want to enforce the payment of those debts via court proceedings.

The funds can be recovered in one of three ways:

- voluntary payments
- deductions from the bankrupt's wages; or
- intercepting and applying tax refunds.

CHAPTER 3
CORPORATE INSOLVENCY & FAMILY LAW

In addition to bankruptcy, issues of corporate insolvency can become entwined with matters of family law. This happens where both parties are co-directors of a company. Unresolved family disputes can also lead to insolvency and liquidation.

Separation and divorce have the potential to send a business into insolvency. Not only can it create challenges in the day-to-day running of the business as the separating parties must continue to work together, but it can also affect shareholders and staff. Small to medium-sized businesses are most at risk.

WHAT HAPPENS IF A BUSINESS IS FACING INSOLVENCY?

If a company is facing insolvency, they generally have two options available to them. Firstly, they can attempt to turn things around and bring their finances back on track. Secondly, they can go into administration or liquidation. A company can also be placed into liquidation if insolvency is presumed by order of a court and in certain other circumstances.

FAMILY COURT

The Family Court has jurisdiction to deal with matters of corporate insolvency.

During Family Court proceedings, each party has an ongoing obligation to give full and frank disclosure. This means business records, financial statements, bank records, BAS and tax documents must be compiled and shared during the process.

Where co-directors of an insolvent business are also separating parties in family law proceedings, both parties must take responsibility for the poor financial state of their business or company and make joint decisions regarding its future.

In cases where relationships have gone sour, this becomes another source of friction.

RESOLVING BUSINESS PARTNERSHIP DISPUTES

When things do go bad in a spousal business relationship due to divorce and business cannot continue as usual, there are four main options available to bring things to a resolution:

1. NEGOTIATE

Negotiation is an extremely effective way to resolve these kinds of disputes. This involves both parties stating their positions and coming to an agreement with the help of a mediator. This may result in them continuing to work together. However, this is rare.

BUSINESS AS AN ONGOING FINANCIAL RESOURCE

If one party is willing to buy the other out, the party who retains the business will continue to have the business as an asset. The court will take this into account when considering the future needs of the parties and adjusting property between them. A settlement sum may also need to be paid to ensure the just and equitable division of assets.

THE MATRIMONIAL PROPERTY POOL

All business interests are **treated by the court as property as defined by the Family Law Act 1975 and fall into the 'matrimonial property pool'**. Each party's business interests will need to be valued if a value cannot be agreed.

2. RESIGN & SELL/BUY OUT (IF A SHAREHOLDER)

If a business is profitable and growing, neither of the parties may want to sell out. However, if one party gets to the point where the dispute is too stressful to continue, they can get their share in the business valued and then sell it to the other party. If there's an intractable dispute as to who retains a business, it may have to be sold.

3. VOLUNTARY ADMINISTRATION/DOCA

This option is more suitable for larger companies that are facing insolvency. In this situation, one of the parties can make an offer through a deed of company arrangement (DOCA) to pay out all of the company's debts as a way of buying out the other party – debt for equity.

4. COURT INVOLVEMENT

Unfortunately, many marital/de facto business conflicts end up in court. This is understandable, given that emotions are running high. In these cases, the court has the power to order that the company be wound up if it is just and equitable to do so. This is a last resort option.

When an irretrievable break down of trust and confidence between persons in control of a company has occurred, such as during divorce, a court can make an order for winding up based on the dispute, deadlock, or mistrust that has arisen as a result.

UNDERSTANDING LIQUIDATION OR WINDING UP

VOLUNTARY WINDING UP

If a company is unable to pay its debts, this is known as a creditors' voluntary winding up.

COMPULSORY WINDING UP

A compulsory winding up is typically instigated by the court, at the request of the creditors. However, it can also be at the request of other shareholders.

WINDING UP ON GROUNDS OTHER THAN INSOLVENCY

Section 461 of the Corporations Act sets out other circumstances in which a court can order a company to be wound up. These include:

- The company by special resolution resolves that it be wound up.
- The directors have acted in their own interests rather than in the interests of the company as a whole.
- The affairs of the company are being conducted in a manner that is **oppressive or unfairly prejudicial** to or unfairly discriminatory against a member or members or in a way that is contrary to the interests of the members as a whole.
- ASIC has stated in a report prepared under Division 1 of Part 3 of the ASIC Act that, in its opinion, the company cannot pay its debts and should be wound up or that it is in the interests of the public, the members, or the creditors that it is wound up.
- If the court considers that it is **just and equitable** that it is wound up.

For the purposes of family law, the two main circumstances used are 'oppressive conduct' and 'just and equitable grounds'.

EXAMPLES OF OPPRESSIVE CONDUCT

- Unfair allocation or restriction of dividends
- One party refusing the other information about the company's affairs
- One party failing to let the other carry out their job, e.g. attend meetings
- Using company funds for improper purposes, e.g. personal expenditure
- A sell-out attempt where improper exclusion has occurred
- Excessive payment to the person gaining control of the company

WHAT CONSTITUTES JUST AND EQUITABLE GROUNDS?

Just and equitable obligations in this context are similar to those arising in partnership relations or 'quasi-partnership cases'.

Court orders for winding up can be made where a company was formed on the basis of a personal relationship involving mutual confidence and:

- the confidence has broken down; or
- one party has been denied access to information or major decisions.

WHAT IS A QUASI-PARTNERSHIP?

A quasi partnership is a company that has all of the characteristics of a partnership, including a relationship of mutual trust and confidence between the members.

THE COST OF COURT-ORDERED WINDING UP

In some cases, winding up by court order can be the only way forward. However, the effects of the order are drastic, and the process can be costly and time-consuming. It's therefore important that negotiation is prioritised where possible.

COURT-APPOINTED RECEIVERS

Where there's a deadlock between co-directors/parties in a divorce over any aspect involving the business and how it is run, one or both of the parties can apply to the court to appoint a receiver. The threat of receivership alone can be enough to make the conflicted parties comply with their obligations.

THE ROLE OF THE RECEIVER

The primary duties of a court-appointed receiver are to take control of and preserve the assets (joint property) of the business until the dispute is resolved. A receiver can also be ordered by the court to dissolve, e.g. sell the assets to pay off debts or settle the matter.

Please note: It's possible for a company to be in liquidation as well as being in receivership.

THE RIGHT TO APPEAL

While directors don't have direct power over the business during the liquidation process, they do retain the right to appeal against the winding up application. In the case of family law, if partners in a business are getting a divorce and one wants to wind up the business, and the other doesn't, they can fight it.

CHAPTER 4
NAVIGATING SECTION 66G

Co-ownership disputes are never pretty. They are often a messy war of wills where neither party wants to give in. When disputes do occur under family law proceedings, Section 66G of the Conveyancing Act can be a valuable tool. But what does it say?

CO-OWNERSHIP DEFINED

Co-ownership is where a property is owned by two or more parties, e.g. a married couple or de facto partners, either as joint tenants or tenants in common. In other words, when two or more people have an interest in a property.

Co-ownership disputes can happen when one co-owner wants to sell land or goods and the other doesn't or when both co-owners cannot agree on how to sell the land or goods. They can arise in different contexts and relate to different types of property.

TYPES OF CO-OWNERSHIP

- **JOINT TENANCY** – Under joint tenancy co-ownership, co-owners have a right of survivorship. This means when one dies the property passes by way of survivorship to the remaining tenant/s.
- **TENANCY IN COMMON** – Tenants in common are viewed as having separate but undivided shares in the property. This means they possess the property at the same time in the proportion noted on the title register. In this instance, when one dies, their interest passes to the beneficiaries nominated in their will.

TYPES OF CO-OWNED PROPERTY

- Real property, e.g. land
- Intangible assets, e.g. goodwill, intellectual property, e.g. trademarks
- Tangible goods other than freehold land or chattel, e.g. shares, a yacht.

BANKRUPTCY, CORPORATE INSOLVENCY, & CO-OWNERSHIP

If the real estate property is a family home and one of the parties is in the process of bankruptcy, the trustee in bankruptcy becomes the co-owner. If the real estate is a co-owned property of a business that is being wound up, the the liquidator becomes responsible.

The application and proceedings involved with applying for a sale or partition are complex, so are best saved for when spouses are really not getting on. Plus, trustees in bankruptcy and liquidators will generally receive a better outcome for creditors in these cases.

Importantly, judges do still have the discretion to order sale and partition, but they must revert to common law principles regarding issues of compensation and accounting between co-owners.

THE CONVEYANCING ACT 1919: SECTION 66G

In NSW legislation, Section 66G is contained in Division 6, Part 4 of the Conveyancing Act 1919 titled 'Statutory trusts of property held in co-ownership'.

SECTION 66G BASICS

Under section 66G, a co-owner of real property other than goods (who owns at least 50% of the property) can apply to the court to appoint trustees to hold the property on a trust for sale or on a trust for partition. This works to force the sale of the property even when one or more parties may object to it.

Applying to the court to appoint trustees for sale or trust for partition is only an option when co-owners cannot reach an agreement to buy the other party out or to sell the property. The property (real estate) in this instance can be private or business-owned.

SALE

A trust for sale is where the trustees are directed to sell the property and hold the money in trust until it can be distributed to the parties following any court orders.

PARTITION

Partition essentially puts an end to co-ownership by subdividing a jointly owned property. New property titles are then converted from joint ownership into separate ownership.

WHICH IS BEST?

While sale may typically be viewed as the best option, partition is sensible where the value of two parts would be more than the value of both sold together. It may also be chosen based on non-financial reasons such as emotional investment.

WHAT HAPPENS WHEN YOU APPOINT A 66G TRUSTEE?

If a Section 66G trustee is appointed, two things happen:

1. The co-owner's rights to deal with the property are effectively lost.
2. People living at the property usually have to vacate before it is sold. If they don't do this voluntarily, the trustee can obtain vacant possession by asking solicitors to obtain orders and having those orders enforced.

Secured debts and the sale costs (including the trustee's costs) are paid when the property settles. In addition, any surplus proceeds are held by the trustee to distribute in accordance with any court orders.

Additional costs also include the appointment of the trustee, the trustee's costs and sales expenses, and any legal fees and court costs associated with making and finalising the appointment, such as obtaining an order of vacant possession.

It's worth noting that the legal fees in appointing a trustee can significantly increase the cost of sale and reduce the proceeds available to the other parties. Therefore, a negotiated sale is always the best option.

OBLIGATIONS OF A 66G TRUSTEE

A Section 66G trustee should do everything they can to sell the property at the highest market values. This includes getting a registered valuation and market appraisal and instructing an agent and solicitor to act on the sale of the property.

We can help guide you through this process as a Section 66G Trustee.

We're always available for a free confidential consultation to talk through your turnaround options and how the process could work – 1300 727 739 | enquiries@rgia.com.au

WHAT DOES IT COST?

The costs associated with a Section 66G appointment vary depending on the circumstances and tasks required. Estimates are based on possible scenarios identified below and may change depending on the circumstances.

SCENARIO 1	SCENARIO 2	SCENARIO 3
• Occupants of the property vacate without the need to apply to court to evict • Property in presentable condition and no repairs/ maintenance required before marketing • Property sold within six weeks from marketing campaign with sale price in line with valuation • Property settlement occurs without delay • No dispute/issues between parties regarding distributions to be made in accordance with court orders	• Occupants of the property don't vacate property and court application required to evict • Property requires minor repairs/maintenance before marketing • Property sold more than six weeks but within three months from marketing campaign with sale price in line or close to valuation • No delays or minor delays in settlement by purchaser • No dispute/issues between parties regarding distributions to be made in accordance with court orders	• Occupants of the property don't vacate property and court application required to evict • Sheriff assistance required to evict occupants in the property • Personal belongings and chattels at property require removal by trustees • Property requires significant repairs/ renovation before marketing • Property sold more than three months from marketing campaign with sale price in line with valuation • Delay in settlement • Dispute between parties regarding distributions to be made by trustees in accordance with court orders

Contact us for an estimate based on the above scenarios or for a confidential estimate based on a client's situation contact - 1300 727 739 | enquiries@rgia.com.au

CONCLUSION

Bankruptcy and corporate insolvency are never ideal in already complicated Family Court proceedings, but the law has made provisions for dealing with them.

KEY TAKEAWAYS

- Non-bankrupt parties and their dependants are protected from the effects of bankruptcy of the other party.
- Family disputes can result in corporate insolvency and lead to liquidation.
- Section 66G offers a solution for disputes over co-owned real estate property.
- The Family Court has the final decision in allocations of property and maintenance but must base its decision on just and equitable principles.

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RAPSEYGRIFFITHS
TURNAROUND + INSOLVENCY

As Registered Liquidators and registered trustees in bankruptcy we have the expertise and authority to act.