

THE POWER OF THE FAMILY COURT TO MAKE ORDERS AFFECTING THIRD PARTIES

Michael Paul

Palm Cove

July 2005

INTRODUCTION

On 17 December 2004 Part VIII AA of the Family Law Act 1975 (“the Act”) came into effect. Whilst the Court has always had some limited powers against third parties under Sections 78 and 85A, the new provisions are quite explicit and probably comply with the admonition that Gibbs J, as he then was, made in the High Court in *Ascot Investments Pty Limited v Harper*.¹

“It can safely be assumed that the Parliament intended that the powers of the Family Court should be wide enough to prevent either of the parties to a marriage from evading his or her obligations to the other party, but it does not follow that the Parliament intended that the legitimate interest of third parties should be subordinated to the interests of a party to a marriage, or that the Family Court should be able to make orders that would operate to the detriment of third parties”.

The Act relies upon the Commonwealth’s legislative power in Section 51 of the Constitution to make laws in respect of “**matrimonial causes and matters incidental thereto**”. The scope of this power was considered by the Full Court of the Family Court in *Gould*² and found to be within constitutional limits.

The Constitutional validity of the amendments was also considered by Paul Brereton SC in a recent paper³. He concluded (in a guarded manner) that they were valid:

“The Family Court already has power, to some extent, under Section 78 (former) Section 85 (now Section 106B), and Section 114, to bind third parties. The powers hitherto conferred have not so interfered with third party

¹ (1981) 148 CLR 337

² *In the Marriage of; Swire Investments Ltd* (1993) FLC 92-434

³ Law Council of Australia 2004 - National Family Law Conference Papers at 545

rights as to take them outside the constitutional bounds of matters reasonably incidental to matrimonial causes. New Part VIII AA 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 AA is questionable, and it should not be assumed that the new provisions would survive a constitutional challenge, though they may”.

PREVIOUSLY

The issue of liabilities to third parties has always been contentious. In *Anderson*⁴ the Court held that it could not make a Declaration in favour of the father of one of the parties to secure to the father the repayment of a loan which he had made to both parties.

In *Zdravkovic*⁵ the Court found a way around the problem of the liability of a party to a third party (being his daughter from a prior marriage) by ordering an indemnity be given to the other party in relation thereto.

In *Re Ross Jones; Ex Parte Green*⁶ the Court had to deal with an acknowledged liability to a mother in law, and found that it could do nothing to prevent action against the husband by such a determined lady.

In many otherwise mundane cases the Court routinely expresses a view that a liability of a party to parent may not be enforced, and accordingly, such alleged liability will not necessarily be taken into account.

OBJECTS OF PART XIII AA

The legislation makes it very clear that the new part of the Act is enacted for the purpose of the allowing the Court,

⁴ (1981) FLC 91-104

⁵ (1982) FLC 91-220

⁶ (1984) FLC 91-555

“in relation to the property of a party to a marriage” to make an order or grant an injunction “that is directed to, or alters the rights, liabilities or property interests of a third party”.

DEFINITIONS

Third party *“in relation to a marriage, means person who is not a party to the marriage”*, that is to say that everyone and every entity is capable of being a third party in relation to any marriage. The realisation of the extent of the power caused consternation amongst those advising many institutions, notably, the Banks.

HOW THE PART OPERATES

Section 90AC is in the following terms:

This Part overrides other laws, trust deeds etc

This Part has effect despite anything to the contrary in any of the following (whether made before or after the commencement of this Part):

- (a) any other law (whether written or unwritten) of the Commonwealth, a State or Territory;*
- (b) anything in a trust deed or other instrument.*

Therefore all that is left in the debate over what can be done for example say in relation to a relevant Discretionary Trust is some cases whether the Discretionary Trust in question is property or a financial resource of a party.

The definition of property has been extended and includes a debt owed by a party to a marriage. In other words such a debt is considered to be the property of the creditor and as such gives the Court the power to make an order with respect to a debt owed by a party to that creditor.

OPERATIVE PROVISION

The key provision is Section 90AE, which in parallel with Section 90AF.

Taken together these Sections simply mean that the Court may make an order or grant an injunction under Section 114 binding upon a third party.

The Sections apply both to proceedings under Section 79 and applications for injunctions under Section 114 and are in the following terms:

In the exercise of a power in Section 79 proceedings or proceedings for an injunction under Section 114 the Court may make any of the following orders:

- (a) an order or injunction 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) an order or injunction directed to a creditor of one party to a marriage to substitute the other party, or both parties, to the marriage for that party in relation to the debt owed to the creditor;*
- (c) an order or injunction 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;*
- (d) an order or injunction 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 party.*

LIMITS OF THE OPERATION OF THE PROVISION

The Act does not apply to eligible annuities which are purchased wholly out of rolled over amounts.

The Court **may only** make an order or injunction as above set out in relation to a third party if:

- (a) the making of the order or the granting of an injunction is reasonably necessary, or reasonably appropriate and adapted, to effect a division of property between the parties to the marriage; and
- (b) if 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 matters mentioned in subsection (4).

The specific matters mentioned in subsection (4) of both Section 90AE and Section 90AF are:

- (a) The taxation effect of the order or injunction on the parties to the marriage or on a third party.
- (b) The social security effect of the orders or injunction of the parties to the marriage.
- (c) Third parties administrative costs incurred consequentially.
- (d) If the order concerns a debt of the party to the marriage – the capacity of a party (i.e. not necessarily that party) to the marriage to repay the debt after the order is made.

Additionally the Court must consider three further matters:

1. The economic or capacity of the third party to comply with the order.
2. If it is a result of the third party being accorded procedural fairness, that third party raises other matters, then those matters must be taken into account; and
3. Finally predictability; or
4. Any other matter that the court considers relevant.

TRUSTEES

Section 98AG provides;

If an order or injunction binds a person in the capacity of trustee in relation to property, then the order or injunction is always binding (by force of this Section) on any person who subsequently becomes the trustee.

THIRD PARTY PROTECTION

Section 90AH provides that a third party is not liable for loss or damage which any other person may suffer because of things done or not done in good faith by that third party in compliance with an injunction made or granted by the Court in accordance with Part VIII AA.

The third party must of course be served with the relevant application and evidence and given an opportunity to be heard.

The third parties expenses must be covered and a third party who has incurred expenses as a necessary result of the order or injunction can have an order made by the Court in the discretion of the Court for the payment of the reasonable expenses of the third party incurred as a necessary result.

Interestingly the usual type of order to be found for example in the 2004 Rules relating to court experts is that, subject to what the Court considers just, the Court must take into account that the parties to the marriage should bear the reasonable expenses of the third party **equally**.

Obviously this is fairly wide open but nevertheless the equality principle is clearly enunciated. Nevertheless the Rules are subject to the provisions of Section 117(1) concerning costs.

Where the Court has not made any order for the reasonable expenses of the third party under Section 90AJ (2) then there is a provision which allows for Regulations to be made under the Act:

1. *For charging by the third party of reasonable fees to cover reasonable expenses of the third party incurred as a necessarily result of the order or injunction; and*
2. *That each of the parties to the marriage is separately liable to pay to pay the third party an amount equal to half of those fees;*
3. *for conferring jurisdiction on a particular court or courts in relation to the collection or recovery of such fees.*

Regulation 15A of the Family Law Regulations permits reasonable fees to be charged, that is, “reasonable fees” to cover “the reasonable expenses” of the third party. Not only a necessary result of the order but covering the expenses incurred in complying.

The regulations give a number of examples which are:

1. Legal and registration fees.
2. Valuation fees.
3. Government charges and duties.
4. Searching, obtaining and producing documents.
5. Postage, delivery, transport or other transmission of documents.

6. Communications with the parties to the marriage or another person.

Regulation 15A(4) reinforces the fact that each party to the marriage is separately liable to pay the third party half of the total amount of the fees charged.

The Court is invested with the jurisdiction to determine what fees are reasonable to make an order in relation to collection or a recovery of these fees.

ESSENTIALS

What is envisaged by the new Part VIII A is:

1. That all third parties will be accorded procedural fairness i.e. given notice and an opportunity to participate.
2. That the order can only be made if the Court considers it reasonably necessary or reasonably appropriate to effect a division of property between the parties to the marriage.

Pausing there, it will be seen that the limitation on the exercise of the Court's power is that otherwise it must be part of the process of adjusting or dividing property interests and such orders should not be made unless to do so is reasonably necessary or appropriate or in some way **adapted** for the purpose of effecting the division. An application for an Order affecting third parties cannot be made other than in the context of proceedings under the Act.

THIRD PARTY CREDITORS

Before the Senate and Legal Constitutional Legislation Committee reported to the Parliament, submissions and concerns were expressed to it particularly by the Australian Bankers Association and similar entities. These were concerns relating to the power of the Court to bind third parties in relation to what were described as "debt products and risks". It was said that

"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 was something which could seriously disadvantage credit providers".

There are some concerns that the Act will be applied in a ruthless manner over the rights of arms length third parties (as opposed to relatives). It would seem to be wrong for the judgment of a Bank or credit provider regarding the credit worthiness of a couple could be disrupted by a discretionary judgment of the Family Court.

However as Mr Brereton suggests in his paper:

“It can be anticipated that where ... orders (substituting one particular creditor where there were previously two), are sought, financial institutions will routinely oppose them”.⁷

The practice has evolved as a matter of conveyancing reality that when a party seeks a transfer of (eg) the matrimonial home to that party, when that home is subject to a mortgage to the Bank, the Bank will no longer transfer the mortgage subject to existing liability and will almost always require that the existing loan to both parties be refinanced with a new obligation undertaken by the one acquiring title.

That is acceptable where what is a voluntary exercise and where there is little doubt about the security. The other party, as a matter of course, will in any event require that such party is relieved of the potential liability arising under the original borrowing.

One could imagine that it would be otherwise where difficult issues of security arose and issues arose as to whether or not the security or the ability to obtain repayment of the liabilities from both parties will obviously increase the exposure of the Bank and lead to many arguments such as Mr Brereton suggests may be “routinely opposed”.

Why is this necessary? Obviously one obtains Indemnity Orders in relation to a liability to a third party. Clearly it will be a better outcome to have the liability extinguished so that there is no need to rely on the Indemnity. The Court’s new power makes this possible although not necessarily likely.

ACQUISITION OF PROPERTY

Section 90AK prohibits the making of an order or injunction if such order or injunction would;

⁷ P Brereton IBID at 554

1. result in the acquisition of property from a person otherwise than on just terms;
and
2. be invalid because of paragraph 51(xxxi) of the Constitution.

How and when will or should one seek such an Order, and how likely is it that any such Order will be made?

We should consider Section 90AE(2) which is in the following terms:

In proceedings under Section 79, the court may make any other order that:

- a) directs a third party to do a thing in relation to the property of a party to the marriage; or
- b) alters the rights, liabilities or property interest of a third party in relation to the marriage.

One could envisage a situation akin to the matters which could arise under Section 106A (formerly Section 85): This is in the following terms:

- (1) In proceedings under this Part, the court may set aside or restrain the making of an instrument or disposition by or on behalf of, or by direction or in the interest of, a party, which is made or proposed to be made to defeat an existing or anticipated order in those proceedings for costs, maintenance or the declaration or alteration of any interests in property or which, irrespective of intention, is likely to defeat any such order.
- (2) The court may order that any money or real or personal property dealt with by any such instrument or disposition may be taken in execution or charged with the payment of such sums for costs or maintenance as the court directs, or that the proceeds of a sale shall be paid into court to abide its order.
- (3) The court shall have regard to the interests of, and shall make any order proper for the protection of, a bona fide purchaser or other person interested.
- (4) A party or a person acting in collusion with a party may be ordered to pay the costs of any other party or of a bona fide purchaser or other person interested of and incidental to any such instrument or disposition and the setting aside or restraining of the instrument or disposition.
- (5) In this section, "disposition" includes a sale and a gift.

It may be a situation in which a party simply cannot be compensated in monetary terms or out of other property. For Section 106A to operate against the transferee it has to be established that the transferrer has been almost a knowing accomplice and that there is a sufficient nexus to proceedings.

Why therefore should an innocent third party have to give up a particular parcel of real estate, jewellery or an interest in or company acquired from a party to a marriage?

Should the community at large be wary of dealing with a party to a marriage in relation to that party's sole property (i.e. not jointly owned) with the other party? This is almost unthinkable, but subject to:

- Section 90K;
- Notice;
- The opportunity to be heard;

an unwary member of the community may become affected by subsequent proceedings in the Family Court.

Perhaps the Application of this power will be rare and limited to matters involving relatives, with some sort of knowledge.

TRUSTS

The Court already has power under Section 106A (Formerly 85A) to make such Orders:

Ante-nuptial and post-nuptial settlements

- (1) The court may, in proceedings under this Act, make such order as the court considers just and equitable with respect to the application, for the benefit of all or any of the parties to, and the children of, the marriage, of the whole or part of property dealt with by ante-nuptial or post-nuptial settlements made in relation to the marriage.
- (2) In considering what order (if any) should be made under subsection (1), the court shall take into account the matters referred to in subsection 79(4) so far as they are relevant.
- (3) A court cannot make an order under this section in respect of matters that are included in a financial agreement.

The key element was that the Section could only operate to deal with the assets of a Trust, if it were a Trust **in relation to a marriage**.

Following a decision by Justice Nygh in *Knight*⁸ it was routine practice to advise members of the family to ensure:

1. That the Trust was not named after a party to the marriage.
2. That various other persons should be included as potential beneficiaries being as far removed from the parties to the marriage as was considered appropriate.
3. That the party was not the appointor or controller.

⁸ (1987) FLC 91-854

Given the usual rule that a Trust apparently controlled by a party to the marriage is considered matrimonial property, in cases where there is not that element of control, and where perhaps regard has been had to the advice referred to above, so that the trust could not necessarily be fitted into the category of a “trust in relation to the marriage”, then the new powers may well be very appropriate.

It will be recalled as pointed out above that Section 90AC provides that this part of the Act has effect despite anything to the contrary in a Trust Deed.

Obviously and subject to procedural fairness (and this will involve an opportunity for the Trustee to be heard), if a Trust is seen to have sufficient nexus to activities during the marriage or to a party to the marriage, but insufficient to satisfy the Section 85A test, then the new powers may well be used.

Additionally we could find that beneficiary accounts could be the subject of orders; trust assets the subject of orders; and even perhaps the provisions of a Trust Deed varied.

COMPANIES

The tale of Mr Harper has often been told but *Ascot Investments* was an example of a determined litigant succeeding in opposition to orders which the Court then did not have power to make.

Specifically, directors of a company can now be made to register a transfer of shares, although it is interesting to note that this power is limited **to registration of a transfer of shares from one party to the marriage to another.**

THE FUTURE

I suspect that occasions for the exercise of the third party powers may well be rare. Nevertheless, the court now has a well-rounded armoury sufficient to cause extreme grief to persons such as Mr Harper.