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BANKRUPTCY LAW: Developments and Update

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Michael joined Piper Alderman as a partner in October 2004. Based in Melbourne Michael leads the Victorian arm of the firm's national Insolvency & Reconstruction Practice Group.

Prior to joining Piper Alderman Michael had been a partner with Gadens Lawyers where he had commenced his legal career over twelve years earlier. In that time Michael has practiced exclusively in the area of commercial litigation specialising in corporate and personal insolvency law. Today he has an enviable reputation as one of Australia's leading bankruptcy lawyers.

In recent years Michael has acted regularly for banks, financial institutions and other secured creditors providing advice in relation to the rights of the secured creditor and the enforcement of those rights. He acts for many of Melbourne's insolvency practitioners. In addition Michael is often engaged to act for companies and directors in relation to insolvency matters and to advise in relation to the restructuring of financially stressed businesses. Michael has acted in some of Australia's high profile bankruptcy administrations and regularly acts for the Official Trustee in Bankruptcy.

Educated at Monash University, he holds degrees in law and economics.

As the Law Council's representative on the National Bankruptcy Consultative Forum, Michael has actively participated in the reform of the Bankruptcy Act in recent years preparing detailed submissions in response to reform proposals and giving evidence to Parliamentary inquiries into various bankruptcy reforms. Most recently Michael was responsible for Law Council's response to the Government's exposure draft of the Bankruptcy "Anti-avoidance" Bill which was ultimately withdrawn

Michael became a member of the IPAA upon the opening of membership to lawyers.

Recent Industry Experience

- Acting for Bank in the enforcement of its security over Victorian arm of a franchise operation through the appointment of a voluntary administrator to master franchisee
- Acting for Bank in the appointment of a receiver to a pharmacy. This included obtaining injunction restraining pharmacist from terminating "Approved Provider Status" under PBS

scheme and liaising with Health Insurance Commission in developing an acceptable strategy to remove debtor pharmacist who failed to co-operate in receivership.

- Provision of expert evidence as to the law of Australia in New Zealand recovery proceedings
- Acting for liquidator of joint venture vehicle incorporated to undertake large scale property development including examination of directors
- Acted for trustee in bankruptcy in High Court case of *Cook v Benson* which considered ability of trustee in bankruptcy to claw back payments to a superannuation fund.
- Acted for IT SME involving recapitalisation and restructure through a deed of company arrangement
- Acted for manufacturing SME that has recapitalised and restructured through deed of company arrangement

Qualifications

- Bachelor of Laws
- Bachelor of Economics
- Admitted to Practice April 1993

Affiliations

- Law Council of Australia, Insolvency and Reconstruction Committee and Chair of the Bankruptcy Sub Committee
- Law Council Representative on National Bankruptcy Forum convened by the Inspector-General in Bankruptcy
- Member of the Insolvency Practitioners Association of Australia

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1. Introduction[1]

"Having managed his military affairs with good success, he was equally happy in the course of his civil government. He took pains ... to heal the differences between debtors and creditors. He ordered that the creditor should receive two parts of the debtor's yearly income, and that the other part should be managed by the debtor himself, till by this method the whole of the debt was at last discharged. This conduct made him leave his province with a fair reputation..."

Plutarch's Life of Julius Caesar

While the rule of Julius Caesar may have been considered just to the citizens of Rome in its day the spate of actual and proposed bankruptcy reform in Australia in the past eighteen months suggests that our laws are yet to reach such state of general acceptance. And while the modern bankrupt may be thankful that our laws no longer contain some of the harsh penalties of ages gone by[2] there are undoubtedly those who lament the passing of the "stocks" as an inducement to a bankrupt to co-operate with his or her trustee in bankruptcy.

With a string of high profile corporate collapses [3] and bankruptcies[4] in recent years the clamour of public opinion has required governments to address perceived shortcomings with our insolvency laws.

In 2004 we have seen a reform agenda in relation to bankruptcy law unseen since the Clyne Report of 1962[5] which formed the basis of Australia's present bankruptcy laws contained in the *Bankruptcy Act 1966* (the Act). This period has seen:-

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[1] The author is indebted to Clifford Hughes of Nicol Robinson Halletts and Ken Shurgott of Thomsom Playford for their assistance in reviewing a draft of this paper and providing helpful feedback.

[2] See for example the penalty meted out to the bankrupt guilty of perjury at his examination under the English Bankrupts Act of 1571, which entailed the nailing of the bankrupts ear to the stocks and his removal from such position by the severing of the ear. For a history of English bankruptcy laws see the extract of the Encyclopedia of the Laws of England (3rd ed, Vol 2) reproduced in the Report of the Committee Appointed by the Attorney-General of the Commonwealth to Review the Bankruptcy Law of the Commonwealth (the Clyne Committee Report) Commonwealth of Australia, 1962

[3] Ansett (2001), HIH (2001), One-Tel (2001) to name a few

[4] For example the Sydney barrister John Cummins

[5] The Report of the Committee Appointed by the Attorney-General of the Commonwealth to Review the Bankruptcy Law of the Commonwealth Commonwealth of Australia, 1962

- the introduction and subsequent withdrawal by Commonwealth Government[6] of an Exposure Draft of the *Bankruptcy Legislation Amendment (Anti Avoidance and other Measures) Bill 2004* (BLAAAM) which sought to introduce laws to overcome asset protection strategies by individuals;

- the passing and commencement of the *Bankruptcy Legislation Amendment Act 2004*[7] *which contained wholesale reform of Part X of the Act;*

- the introduction into Parliament of the *Bankruptcy and Family Law Legislation Amendment Bill 2004* which has already been debated but has been referred back to the Senate;

- the announcement on 8 February 2004 by the Commonwealth Attorney-General of the release of a discussion paper calling for submissions to strengthen the bankruptcy anti-avoidance provisions[8].

- the announcement on 16 December 2003 by the Attorney-General of the Government's intention to amend the bankruptcy laws with respect to the protection of superannuation entitlements following the decision of the High Court of Australia in *Cook v Benson*[9];

- the undertaking of a review of offences under the Act;

This does not include the several initiatives to reform the corporate insolvency regime contained in the Corporations Act. Finally we are still awaiting a response to various submissions to the Government that legislative amendments be introduced to nullify the implications of the decision in Hanel v O'Neill[10].

Much of the reform undertaken in recent years has been non-controversial. However the Bill presently before Parliament and the current reform agenda have a number of controversial implications for individuals and the way they may structure their affairs. In this paper we will seek to review these reforms and such implications. Whether they will in due course receive the regard extended to the laws of Julius Caesar, time will tell.

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[6] Section 51(xvii) of the Constitution of the Commonwealth of Australia empowers the Commonwealth to make laws with respect to bankruptcy and insolvency. Any reference to legislative reform with respect to bankruptcy law will be a reference to reform of the laws of the Commonwealth unless otherwise specified.

[7] No.80 of 2004

[8] See Press Release 018/2005 released by the Attorney General the Honourable Phillip Ruddock dated 8 February together with the Discussion Paper of that date.

[9] (2003) 77 ALJR 192

[10] (2003) 180 FLR 360

2. The Insolvent Trading Trust: Hanel v O'Neill

3. Superannuation and Bankruptcy

3.1 History

Section 91(b) of the *Bankruptcy Act 1924-1960* (C'th) excluded from property divisible amongst a bankrupt's creditors policies of life assurance or endowment in respect of the bankrupt's life, except to the extent of a charge on the policies in respect of the amount of the premiums paid in the 2 years preceding the date of bankruptcy. The "Clyne Committee"[11] in considering this exclusion found:

> "*It has been for many years the policy of Parliaments throughout Australia to give protection to policies of life insurance against claims of creditors. The Committee recommends that, if a policy of life or endowment assurance has been in force for more than two years before the bankruptcy, neither the policy nor its proceeds should form part of the divisible property of the bankrupt…if the policy has been in force less than two years, no protection at all should be given to the policy…..The reason for this last recommendation is that a debtor on the verge of bankruptcy may, at the expense of his creditors, take out policies for substantial amounts for the benefit of himself or his dependants*." (emphasis added)

This recommendation was reflected in section 116(2)(d) of the Act upon its enactment.[12]

The present section 116(2)(d) of the Act was introduced by the *Superannuation Industry (Supervision) Consequential Amendments Act 1993*[13] ("the SIS Act") the substantive provisions of which commenced operation on 1 July 1994. It extended the exemption as to the property that is not divisible amongst the creditors of the bankrupt to, *inter alia*, the interest of the bankrupt in a regulated superannuation fund.[14]

Paragraph 116(2)(d) now provides that subsection 116(1) (property divisible amongst creditors) does not extend to:

> (d) Subject to subsection (5):

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[11] *Report of the Committee Appointed by the Attorney-General of the Commonwealth to Review the Bankruptcy Law of the Commonwealth* (1962) at paragraphs 155-156

[12] See also the protection afforded policies of pure endowment and annuities

[13] (No. 82 of 1993)

[14] It is to be noted that the exemption also extends to a bankrupt's interest in a specified insurance policy the value of which is to be included in the calculation of the bankrupt's interest up to the RBL.

(i) policies of life assurance or endowment assurance in respect of the life of the bankrupt or the spouse of the bankrupt[15];

(ii) the proceeds of such policies received on or after the date of the bankruptcy;

(iii) the interest of the bankrupt in:

(A) a regulated superannuation fund (within the meaning of the Superannuation Industry (Supervision) Act 1993); or

(B) an approved deposit fund (within the meaning of that Act); or

(C) an exempt public sector superannuation scheme (within the meaning of that Act);

(iv) a payment to the bankrupt from such a fund received on or after the date of the bankruptcy, if the payment is not a pension within the meaning of the Superannuation Industry (Supervision) Act 1993;

(v) the amount of money a bankrupt holds in an RSA;

(vi) a payment to a bankrupt from an RSA received on or after the date of the bankruptcy, if the payment is not a pension or annuity within the meaning of the Retirement Savings Accounts Act 1997.

Sub-sections 116(5) to 116(7) then proceed to limit the exception contained in 116(2)(d). In particular:

(5) The following provisions apply in working out how subsection (1) extends to property covered by paragraph (2)(d):

(a) if the total value of the property does not exceed the bankrupt's pension RBL (worked out under section 140ZD of the Income Tax Assessment Act 1936) for the year of income in which the date of the bankruptcy occurred—subsection (1) does not extend to any of that property;

(b) if the total value of the property exceeds that pension RBL—subsection (1) does not extend to so much of that total value as equals that pension RBL.

[15] The definitions of a policy of "life assurance" and "endowment assurance" were considered in *NM Superannuation Pty Ltd v Young* (1993) 41 FCR 182. A policy of life assurance is one where "*a party agrees to pay a given sum upon the happening of a particular event contingent upon the duration of a human life in consideration of the immediate payment of a smaller sum*" or certain periodical payments. An endowment policy is one which "*provides for payment of the sum insured at some future date ...or earlier death*". Life insurance would include a policy of endowment assurance.

(6) The regulations may set out a method for determining how one or more items of property are to be apportioned for the purposes of paragraph (5)(b). For example, if the bankrupt's pension RBL is $800,000 and the bankrupt has 2 items of paragraph (2)(d) property each with a value of $500,000, the regulations could provide that subsection (1):

(a) does not extend to the first item; and

(b) does not extend to so much of the value of the second item as equals $300,000.

(7) The regulations may provide for a special method of working out the value of a specified kind of property for the purposes of subsection (5).

The *Bankruptcy Regulations*[16] have detailed provisions for the calculation and payment of that part of a fund that vests in a trustee in bankruptcy.

The effect of sub-section 116(5), when taken in conjunction with sub-section 116(2)(d), is that a member's interest in a regulated superannuation fund does not vest in the member's trustee in bankruptcy to the extent the fund does not exceed the pension RBL applicable to the bankrupt, as worked out in accordance with section 140ZD of the *Income Tax Assessment Act 1936* ("the ITAA"). To the extent the member's interest exceeds the pension RBL it is available to creditors.

Section 140ZD(2) of the ITAA provides that

A person's pension RBL for a year of income is:

(a) if the year of income is the 1994-95 year of income-$800,000; or

(b) if the year of income is the 1995-96 year of income or a later year of income-the amount worked out under paragraph (a) subject to the indexation arrangements set out in subsection (3).

The pension RBL for a person becoming bankrupt in the 2004-2005 year is $1,238,440.00.

It has generally been accepted that the limit of the protection afforded superannuation upon bankruptcy is the pension RBL. However it is yet to be determined whether an individual's "transitional" RBL may be held to apply to the definition of "pension RBL" for the purpose of sub-sections 116(2)(d) and 116(5) of the Act. If it did it is argued that this would increase the level of the exemption applicable to the bankrupt member's interest in a superannuation fund.

[16] Division 3 of Part 6 of the *Bankruptcy Regulations*.

The ability to obtain a "transitional" RBL arose out of the need not to prejudice a member's interest in a fund prior to the introduction of the SIS Act. Essentially it permitted a member's pre 1 July 1994 interest in a superannuation fund to be treated separately for tax purposes. Section 140ZE(2) provided that

> *In spite of section 140ZD, the regulations may provide for a special method of calculating a person's pension RBL for a year of income if the calculation results in a greater amount than would be applicable under section 140ZD.*

It may be suggested that section 140ZD(2) is to be read as subject to or qualified by, section 140ZE(2) for the purposes of the Act by reason of the inclusion of the words "In spite of". If so, a person's pension RBL in a bankruptcy case is not to be calculated only by reference to section 140ZD(2) but by the applicable pension RBL of the specific individual as adjusted by any transitional treatment.

It is submitted that the Act is plain in its terms and makes no reference to section 140ZE nor seeks to qualify section 140ZD(2) as being subject to any transitional application. The use of the words "in spite of" in section 140ZE(2) suggests that this section carries a mutually exclusive application, not one to be read in conjunction with section 140ZD.

Section 302A and 302AB were also introduced into the Act by the SIS Act. Section 302A provides:

> *(1) This section applies to a provision in the governing rules of a provident, benefit, superannuation, retirement or approved deposit fund to the extent to which the provision has the effect that:*
>
> *(a) any part of the beneficial interest of a member or depositor is cancelled, forfeited, reduced or qualified; or*
>
> *(b) the trustee or another person is empowered to exercise a discretion relating to such a beneficial interest to the detriment of a member or depositor;*
>
> *if the member or depositor:*
>
> *(c) becomes a bankrupt; or*
>
> *(d) commits an act of bankruptcy; or*
>
> *(e) executes a deed of assignment or a deed of arrangement under this Act.*

(2) The provision is void.

(3) This section applies to governing rules made before the commencement of this section.

(4) In this section:

governing rules, in relation to a fund, means any trust instrument, other document or legislation, or combination of them, governing the establishment or operation of the fund."

3.2 The Nature of a Members Interest in a Superannuation Fund

Section 19 of the SIS Act provides that for a superannuation fund to be "regulated" it must have a trustee. Generally, the importance of being a "regulated" fund lies with the concessional tax treatment afforded superannuation. However, as noted above, the other benefit afforded a regulated superannuation fund is the protection afforded a member's interest by the Act.

In *Scott v Commissioner of Taxation (No.2)*[17] Windeyer J gave a general description of a superannuation fund as follows:

> *"I have come to the conclusion that there is no essential single attribute of a superannuation fund established for the benefit of employees except that it must be a fund bona fide devoted as its sole purpose to providing for employees who are participants money benefits (or benefits having a monetary value) upon their reaching a prescribed age. In this connexion 'fund', I take it, ordinarily means money (or investments) set aside and invested, the surplus income therefrom being capitalized. I do not put this forward as a definition, but rather as a general description."*

Therefore, in its essential form, a regulated superannuation fund is no more than a trust created for the purpose of providing monetary benefits to its members.

Superannuation trust funds will, as a rule, be discretionary trusts in nature. Accordingly until such time as a "vesting" event occurs the interest of a member in a superannuation fund might be categorised as a mere expectancy which is not property that is capable of vesting in a trustee in bankruptcy.

This principle was explained by O'Loughlin J in *Re Coram; Ex parte the Official Trustee in Bankruptcy v Inglis &Ors* .[18] His Honour held:

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[17] (1966) 40 ALJR 265 @ p 278

> "*Historically, a superannuation fund was a form of trust that an employer established for the benefit of his employees. A common form of benefit was a lump sum payment that was payable to the employee (or his dependents) upon the event of his retirement or earlier death; another well-known benefit was a pension plan. Conceptually however, the employee was only intended to benefit upon retirement; thus he would not necessarily receive any part of the amount allocated to the credit of his account if there was an early resignation or a dismissal. The emphasis on the benefit maturing upon retirement also emphasised that until retirement the member's rights to or interests in any benefit were inchoate and would not crystallise until retirement (or earlier death). Even though the benefits afforded through superannuation funds have improved materially over the years - in particular, it is common place for some reduced benefit to vest upon premature retirement and for provisions to cover illness and injury - the inchoate nature of the member's rights or interests have remained unaltered. Until the happening of a prescribed event that will crystallise his right into an actual entitlement, a member of a superannuation fund is neither the legal nor the beneficial owner of the amount that stands to the credit of his account from time to time.*"

His Honour went on to hold that the non-vested interest of a member in a superannuation fund, being no more than an *inchoate right*, was not property that would be available to a bankrupt's creditors.

Given the findings in *Re Coram* the operation of the exemption contained section 116(2)(d) of the Act is in fact limited to the situation where an interest of a member in a superannuation fund has vested in the member after the commencement of the bankruptcy. It says nothing of former interests in funds. Such "vesting" will be expressed in the trust deed and might be include cessation of employment through redundancy, retirement or permanent disablement.

However Gummow J in the Bond case[19] held, in addressing the interest of Alan Bond in a superannuation fund, that upon the constitution of the fund Bond acquired "*an equitable proprietary interest in the fund, albeit one which did not carry an immediate right to payment…. The interest…was conditional in the sense that no benefit might be paid until certain conditions were satisfied*". That interest was of a proprietary nature that would be capable of vesting in a trustee in bankruptcy. The remaining members of the Full Federal Court in that case, Ryan and Lee JJ, did not address this issue.

There is New Zealand authority that would support the position taken by Gummow J[20].

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[18] *Re Coram; Ex parte The Official Trustee in Bankruptcy* (1992) 36 FCR 250.

[19] *Caboche v Ramsay* (1993) 119 ALR 215 @ p.230

[20] In *Official Assignee v NZI Life Superannuation Nominees Ltd* [1995] 1 NZLR 684, the Court observed at 697 (distinguishing *Re Coram*):

Bonds case[21] is an example of where the interest of a bankrupt in a superannuation fund had vested in the bankrupt and was found to be available to the trustee in bankruptcy. Of greater importance, however, this case confirmed that any provision in the superannuation trust deed which sought to alienate the "vested" interest would be declared void by the Court, it being contrary to public policy to restrict the alienation of vested interests. In *Re Coram* the Court made no adverse comment with respect to the "forfeiture" of a members *inchoate* rights upon bankruptcy. The distinction between the cases is that forfeiture of non vested right can not be a restraint on the right to freely alienate a vested right in property.[22]

The decisions in *Bonds* case and *Re Coram* ultimately led to the 1993 amendments to the Act. However, an analysis of these cases leads one to conclude that:

- in light of *Bonds* case section 302A can be seen as no more than a restatement of the common law position;
- until such time as a vesting event occurs a member of a fund has no interest capable of vesting in a trustee in bankruptcy and the protection afforded by section 116(2)(d) might be seen as illusory; and
- section 116(2)(d) still fails to protect an interest in a fund that has vested in the debtor prior to bankruptcy.

Having reached a position of determining that some part of a bankrupt member's interest in a superannuation fund is available for creditors there remains an issue for the superannuation trustee as to its ability at law to meet any demand made by the bankruptcy trustee. In particular section 62 of the SIS Act requires that a trustee of a regulated superannuation fund **must** ensure the fund is maintained solely for one of the "core purposes"[23] or one of the "ancillary" purposes. "Ancillary purposes" include "*the provision of such other benefits as the Regulator approves in writing*".[24] However this section must also be read with section 349A of the SIS Act which provides that nothing in the SIS Act or SIS Regulations is to prevent a

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I have no doubt that the interest of a member in a superannuation fund is a "valuable thing" though it may be difficult to quantify the value at any given time. In respect of the member's rights there is, at the least, a contingent interest arising out of that valuable thing. Therefore, if any forfeiture clause is disregarded, in New Zealand an Official Assignee becomes vested under s 42 with the bankrupt's rights, whatever they may be, in relation to a superannuation scheme: they are "property . . . belonging to", if not "vested in", the bankrupt.

[21] *Caboche v Ramsay* (1993) 119 ALR 215

[22] See *Caboche v Ramsay,* above at p 226-228

[23] "Core purposes" are generally defined to include provision of benefits to members upon retirement, death or disablement

[24] Section 62(1)(b)(v) of the SIS Act

superannuation trustee paying to the bankruptcy trustee an amount otherwise vested in the bankruptcy trustee.[25]

While the operation of section 349A might be considered sufficient to override the express provisions in the SIS Act restricting early payment of any benefit to a member it is to be remembered that the bankruptcy trustee, which essentially stands in the shoes of the bankrupt member, has no better entitlement to withdraw the funds than that member. In *Re Kirkland; Ex parte The Official Trustee in Bankruptcy*[26] the Court held that notwithstanding the vesting of a member's interest in a superannuation fund in a bankruptcy trustee the provisions of the SIS Act require retention of the members interest in the fund until one of the vesting events. Therefore the question for a bankruptcy trustee is whether it can access the member's interest prior to retirement?

Under section 328 of the SIS Act the Regulator (APRA) may restrict persons (in this case superannuation trustees) from the operation of any "modifiable provision". Regulation 6.22B of the SIS Regulations is a "modifiable provision" within the meaning of the SIS Act. It provides:

> ***6.22B When benefits in regulated superannuation funds may be cashed in favour of persons except members***
>
> *A member's benefits in a regulated superannuation fund may be cashed in favour of a person other than the member if:*
>
> *(a) the cashing is expressly permitted by the Regulator in a written approval for the purposes of subparagraph 2(1)(b)(v) of the Act;*

The answer, therefore, for the bankruptcy trustee, is to seek a determination from APRA for the early release of benefits to the bankruptcy trustee. Given the lack of financial interest of any other party it would be unusual for such requests to be declined. As to the tax consequences of such a withdrawal it is suggested that the same rules would apply as for any early withdrawal of benefit.

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[25] Section 349A provides:

If a member of an approved deposit fund or of a regulated superannuation fund becomes a bankrupt, within the meaning of subsection 5(1) of the Bankruptcy Act 1966, nothing in this Act or the regulations prevents a trustee of the fund from paying to the trustee in bankruptcy an amount out of the fund that is

3.3 **Benson's Case**

Between 1972 and April 1990 the Bankrupt had been employed by ISAS. In January 1990 proceedings were brought against the Bankrupt and a related company for in excess of $200,000.00. In May 1990 a judgement on another claim was awarded against the Bankrupt.

ISAS was wound up on 4 June 1990 and, on account of the termination of his employment, the Bankrupt obtained a vested interest in the company's superannuation fund. The Bankrupt directed that the majority of the funds vested in him be paid to 3 separate "arms length" superannuation funds. He went bankrupt shortly thereafter.

The trustee in bankruptcy sought to set aside each of the 3 dispositions to the 3 superannuation funds as being void against him by virtue of section 120, alternatively section 121 of the Act. It is to be noted that the trustee proceeded under the pre-1996 amended version of sections 120 and 121. The bankrupt neither led evidence nor sought to cross examine the trustee as to the case put against him.

Sections 120 of the Act, as it applied to this case, provided relevantly:

> *"a settlement of property ... not being ... a settlement ... made in favour of a purchaser or encumbrancer in good faith and for valuable consideration ... is, if the settlor becomes a bankrupt and the settlement comes into operation after, or within 2 years before, the commencement of the bankruptcy, void as against the trustee..."*

Sub-section 120(8) of the Act provided that, "settlement of property" includes "any disposition of property".

Section 121 of the Act as it then applied, provided that

> *"a disposition of property ... with intent to defraud creditors, not being a disposition for valuable consideration in favour of a person who acted in good faith is, if the person making the disposition subsequently becomes a bankrupt, void as against the trustee ...".*

The Honourable Justice Marshall, at first instance, held:

- the bankrupt had a vested interest in a fund of money that was the subject of a disposition by him to the superannuation funds;

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property divisible amongst the member's creditors, within the meaning of section 116 of the Bankruptcy Act 1966.

[26] (unreported, FCA, Heerey J, (25 July 1997))

- the bankrupt's interest did not attract an exemption under section 116(2);
- the disposition had occurred within 2 years of the commencement of the bankruptcy; and
- the superannuation funds did not give any consideration for the payments received by them. They had merely pledged to manage and preserve the funds on certain trusts for which they would be remunerated.

His Honour accordingly held the payments to be void as against the trustee by virtue of section 120 of the Act. He did not find it necessary to consider section 121 of the Act. Orders were made that the accumulated benefits in the funds be paid to the trustee.

On appeal the case focused upon the central issue as to whether the superannuation funds gave "valuable consideration" for the payments made to them. In a 2-1 decision, the decision of Marshall J was reversed (the Honourable Justices Beaumont & Kieffel in the majority, the Honourable Justice Hely dissenting).

The Court was united in finding that the bankrupt had a vested interest in property which had been disposed of by him to the superannuation funds within the meaning of section 120 of the Act. The use of the term "roll over" of a fund was irrelevant to that finding.

On the question of whether the funds were "purchasers" Beaumont J held:

> "*But having so widened the net so as to embrace an expanded notion of "settlement", Parliament must, I think, be taken also to have intended that the concept of "purchaser" or "purchase" would, in line with this expansion, also be expanded, so as to achieve a consistent approach overall. That is, if (as here) Parliament is to be taken to have intended that a payment of money, or a transfer of a chose in action to a superannuation trustee is capable of constituting a statutory "settlement", it is only reasonable to assume that Parliament intended that such a trustee was also capable of qualifying as a "purchaser ... for valuable consideration". Any other result would be so unfair and arbitrary as to be presumed not to have been intended. As a matter of statutory interpretation, I would reject such construction in the present context*"

He went on to hold in relation to the question of "valuable consideration" that:

> "*The contemplated role of the related assurance company, guaranteed by the fund's trustee, was of fundamental practical importance to the superannuation transaction. In return for premiums received, the fund's trustee promised the beneficiary that the assurance company would provide assurance cover. This involved the provision of a*

real and truly valuable quid pro quo by the fund's trustee. These were not nominal, colourable, abnormal or collusive dealings of the kind aimed at by s 120"

Kiefel J, on the question of consideration, held:

"*Here the appellant's rights can be seen to have been altered by the transaction. In lieu of the money to which he was entitled he now has future rights with respect to the fund and rights arising from his contracts with each of the respondents. The respondents have corresponding obligations which will require the repayment to the appellant of his initial investment together with an amount representing the monies earned by the fund relative to the investment. On any view it would seem to me that something more than a nominal consideration has been provided for the monies. It follows that neither section 120 nor section 121 can have application.*"

Hely J analysed the question of consideration from the strict position of a trustee having money settled upon it. His Honour, dissenting, held:

"*The policies in question are settled on the trustees, on the terms of the Trust Deeds. Whilst there is reference in the correspondence to which I have referred to "units", there is nothing in the appeal papers or in the judgment at first instance which establishes that the appellant has some different or other entitlement vis-à-vis the trustees of the Funds than as beneficiary of the relevant trust. Corin v Patton (1988) 13 NSWLR 15 at 29; (1990) 169 CLR 540 at 577 confirms that a trustee who promises to receive and hold property transferred to him as a bare trustee does not thereby give valuable consideration for the property transferred. Here the trustees are more than bare trustees, but the benefits which the appellant derives from membership of each of the three Funds relied upon as constituting the provision of valuable consideration by the trustees, flow from the terms of the constating deeds.*"

The majority, in finding that valuable consideration was granted by the funds in return for the payments to them, upheld the appeal.

The trustee in bankruptcy subsequently appealed to the High Court of Australia[27]. In a 4-1 decision the majority (the Honourables Gleeson CJ and Gummow, Hayne and Heydon JJ) dismissed the appeal finding that the superannuation funds had given valuable consideration. The majority held (at paragraph 33);

"*In the present case, the payments in question were made pursuant to arm's-length, commercial transactions. The payments, at the direction of the first respondent, out of the funds due to him under the ISAS superannuation scheme, by way of contributions*

[27] *Cook v Benson* (2003) 77 ALJR 1292

to other, commercially marketed, superannuation schemes, were made in return for the obligations, undertaken by the trustees of those schemes, to provide him with the rights and benefits to which he would in due course become entitled under the rules of each scheme. Those rights and benefits constituted substantial and valuable consideration for the contributions of the first respondent."

The Honourable Justice Kirby, in dissenting, held:

"*It is extremely difficult, if not impossible, to describe the corporate respondents in this case as the "buyers" of the respective sums making up the $80,000 paid to them at the direction of the first respondent. It is true that an entitlement to a sum of money may constitute a chose in action. A bundle of currency may amount to a form of personal property and thus may, in some circumstances be sold to a "buyer". However, this would ordinarily be possible only where the sale contemplated the purchase of foreign money for a quantity of local money or, possibly, different money for a quantity of local money that was subject to a risk of devaluation or withdrawal as legal tender. None of those circumstances applied here.*"

While it was not expressly dealt with by the High Court it follows from the judgment (and should be presumed) that the rights and benefits flowing from the superannuation trustee may constitute property that would otherwise vest in a trustee.

One would wish to have regard to the terms of the trust deed itself in determining this question. It is open for the superannuation deed to provide that the interest of a member be it vested or not, is of a proprietary nature. Alternatively the rights and obligations may in fact give rise to no more than a mere expectancy. In this regard the Full Court of the Federal Court has recently distinguished the decision of the High Court in *Cook v Benson* in *Anscor Pty Ltd v Clout* [28]. The Court (Lindgren J, with whom Wilcox & Moore JJ concurred) held, in distinguishing *Cook v Benson* that;

209 The majority observed that the three payments were made for the acquisition of the rights secured by the respective deeds of trust and were enforceable by the bankrupt against the respective trustees.

210 The majority distinguished Tooheys, stating (at [36]):

'The payment of [sterling]50,000 by the company to the trustees was not made in return for any property, or right, received by or conferred upon the company in return. On the other hand, in the present case the first respondent made contributions in return for the undertaking by the trustees of the funds of obligations to pay

death, retirement or other related benefits, to him or his nominees, in accordance with the rules of the respective funds. He obtained consideration in money's worth in return for the payments.'

211 Anscor did not pay the $1,500,000 as the price of undertakings provided by Thornville, whether for the benefit of Anscor or of any other person, and Thornville did not give its promises as an exchange for the payment to it of $1,500,000. Rather, the sum of $1,500,000 was the property in respect of which Thornville's promises operated.

212 Thornville did not give any consideration for the contribution of $1,500,000 paid to it by Anscor, let alone 'consideration that was at least as valuable as the market value of the property [$1,500,000]'.

It might also be suggested that the decision in *Cook v Benson* was a "just" outcome in that Mr Benson had been prevented from "rolling over" his non-vested interest in the fund by virtue of the receivership and his cessation of employment giving rise to a vesting event. It is to be remembered that the fund in that case was an employer fund over which it might be expected Mr Benson had exercised some control. The receivership and termination of his employment were unlikely to have been a surprise to Mr Benson. If he had turned his mind to the issue he may have taken action to prevent a vesting event occurring. As it was he was able to successfully divest himself of an asset that should otherwise have been available to creditors.

3.4 *Official Trustee v Trevor Newton Small Superannuation Fund Pty Ltd*[29]

While judgement of the decision of the Full Court in Benson's case was reserved the decision of the Honourable Justice Madgwick was delivered in the Trevor Newton Small case.

In this case the Bankrupt was served with a statement of claim from the ATO in which an amount of approximately $400,000.00 was claimed. Two months later the Trevor Newton Small Superannuation Fund was established as a regulated self managed fund of which the Bankrupt was a member. The Bankrupt proceeded to make 3 cash payments to the fund totalling approximately $260,000.00. The last payment was made after the commission of an act of bankruptcy by the Bankrupt.

His Honour noted the policy requiring the protection of superannuation generally. He held:

"I agree with the respondent's submissions that the protection offered by section 116(2)(d)(iii)(A) is part of a broad legislative policy, manifest in a number of statutes

[28] (2004) 135 FCR 469

touching superannuation, actively encouraging individuals to provide for their own future and retirement rather than to rely on government assistance. In order to achieve this goal, the legislature has provided for a person's interest in a regulated superannuation fund to be protected in the event that he or she should become bankrupt: the legislative policy seems to be that a person should not lose what he or she has bona fide managed to provide for retirement merely because that person becomes insolvent.

24 However, in my opinion the legislative protection is not as broad as the respondents submitted. There is a need to draw a distinction between an interest and a payment into a fund. I have little doubt that the protection provided for by section 116(2)(d)(iii)(A), operates in favour of any lawful interest in a regulated superannuation fund. However, the exemption of a wide range of superannuation interests from divisibility, along with a bankrupt's other property, amongst the creditors (subject to section 116(5)) applies to the interest. This does not exclude the potential for a payment to a superannuation fund to be caught by the relation back or avoidance provisions of the Bankruptcy Act, even though that payment gives rise to the interest in the fund, which is protected." (emphasis added)

On the question of consideration His Honour held:

"*The promises and guarantees that the superannuation fund trustee provided pursuant to both the trust Rules and the provisions of the SIS Act, as well as the management services it provided, were not provided as consideration for the three contributions made by Mr Small. Those services were provided in return for the management fees and charges that that trustee was permitted by the Rules under the Deed to charge the fund for the administration of it. I do not accept that the first respondent has otherwise provided any consideration for which it is entitled to receive repayment under s 121(5).*"

His Honour otherwise held:

"*In my opinion, it is readily to be inferred from all the circumstances that, at the time of both transfers (and also the third transfer), Mr Small was or was about to become insolvent, thereby establishing the requisite purpose in s 121(1)(b)(i).*"

In the result the payments were held to be void by virtue of section 121 of the Act. The trustee of the superannuation fund, not having paid any consideration, was not entitled to any refund by virtue of sub-section 121(5). The third and last payment, being paid after the commencement of the bankruptcy were recoverable by virtue of section 129(4) of the Act.

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[29] (2001) 114 FCR 160

3.5 The Future

The decision in *Benson* is a cause for concern in that it potentially "opens the door" to debtors to be able to place funds beyond the reach of their creditors.

It is submitted that despite *Benson's* case being decided in the context of the pre 1996 amendments to section 120 of the *Bankruptcy Act* it continues to have application under the existing sections 120 and 121. Having found that valuable consideration is given by a superannuation fund in return for the payment of funds to it, it arguably follows that the promise to manage the fund and repay the investment at a later date must be at least of equal value to the original contribution. If that is found to be the case then it will be extremely difficult for a trustee in bankruptcy to claw back any payments to an arms length fund either under section 120 or section 121. This is because it is likely to be found that consideration of "market value" will have passed to the Bankrupt.

In relation to a claim by a trustee in bankruptcy under section 121, sub-section (4) provides that a transfer of property is not void under that section if the transferee gave valuable consideration and "acted in good faith". It is expected that the Trevor Newton Small type case would continue to be subject of attack because a trustee would generally establish the requisite degree of knowledge under section 121(4) in the case of a self managed fund. However in the case of a payment to an unrelated "arms length" fund it would be difficult to prove the requisite degree of knowledge on the part of the fund.

In answer to these concerns on 16 December 2003 the Attorney-General announced that amendments would be made to the Act, having operation from that date, so as to remove this potential loophole. We are yet to see the draft legislation in this regard.

Since that announcement, the office of the Inspector-General in Bankruptcy has consulted widely with various interest groups as to possible ways in which the problem may be resolved. In early 2004 a presentation was given to various interest groups outlining the Government's plan for reform. The initial proposals have attracted significant criticism from bankruptcy lawyers as being overly complicated and not necessarily addressing all concerns that may arise. It is apparent that the complexity has arisen out of difficulties in defining that which ought to be protected upon bankruptcy and of the implications of withdrawing money from a superannuation fund prior to the vesting event to be paid to a non member. For example, at what level will the general policy of affording protection to superannuation savings upon bankruptcy be overridden by a need to prevent abuses of the system? In addition concerns have been raised as to how a trustee of a public fund must allocate any member benefits in the event a trustee succeeds in clawing back payments. There are also a number of taxation implications that need to be addressed. For instance, does or should the clawing back of a payment to a superannuation fund entitle the fund to a rebate on any taxes paid upon the

contributions. And should such rebate then accrue to the interest of the bankruptcy trustee. These are matters which have been of particular interest to the superannuation industry which, during the consultation process, has sought to have them addressed in any amending legislation. It is the attempt to address each of these legitimate concerns that has led to the level of complexity

It is suggested that the heart of the problem lies in defining the extent to which superannuation is to be protected upon bankruptcy. Once that policy decision is made it should be a simple matter to incorporate a deeming provision within s.120 whereby a trustee of a superannuation fund (or indeed any trust) is deemed not to have provided consideration for a payment to it. Such provision could then sit alongside an amendment to s.116(2) whereby certain levels of contributions (say such amount annually up to the member's mandatory contributions or his or her tax deductible limit) are expressly protected. It is queried as to what extent in fact trustees of funds may encounter issues in withdrawing funds following a court order.

.A summary of the proposed changes, based upon the presentation given during the public consultation process, is contained in the Appendix hereto. The website maintained by the Insolvency Trustee Service Australia[30] also contains a brief summary of the proposed legislative reforms. The report however provides no indication as to when these changes might be made.

4. Family Law and Bankruptcy

5. Strengthening Bankruptcy Laws

6. Conclusion: Implications for SME practice and structuring

[30] www.itsa.gov.au

7. Appendix

On the basis of that presentation it seems that the proposed legislation is intended to be structured as follows[31]:-

- Recovery Procedure
    - Official Receiver (OR) or Bankruptcy Trustee (BT) may give the Superannuation Trustee (ST) a Cashing Notice requiring the ST to pay to the BT the lesser of:
        - the recoverable amount
        - the amount specified in the proposal notice
    - within four days of the date of effect of the notice, ie 28 days after Cashing Notice given to ST
    - OR may extend the date of effect by notice to ST
- Protection from Civil Liability
    - ST is not liable for loss or damage suffered by any person because of anything done (or not done) by the trustee in good faith in reliance on the Cashing Notice
    - An amount that the ST pays under a Cashing Notice is taken to have been authorised by:
        - the member
        - any other person who is entitled to the whole or a part of the amount
- The Recoverable Amount
    - BT may recover so much of the value of superannuation interest as is attributable to:
        - excess contributions but not allowable contributions
        - tainted contributions
        - the member's unallocated forfeited amount

[31] The author is grateful to Mr Garry Bigmore QC who provided the summary of the proposed changes and has kindly provided his permission to reproduce that summary herein.

- net earnings on those contributions / amounts

- Value of superannuation interest
  - value of member's withdrawal benefit on the day the Cashing Notice takes effect
  - 'withdrawal benefit' defined as in SIS Regulations, ie total benefit payable to a member who voluntarily leaves the fund
- Who may give Cashing Notice?
  - BT may not give Cashing Notice, unless recipients of Proposal Notice have agreed to the recovery
  - If no agreement, OR may give the Cashing Notice
  - OR must take into account submissions by recipients of Proposal Notice
- Revocation of Cashing Notice
  - OR or BT may revoke the Cashing Notice by notice to the ST
- Court may set Cashing Notice aside
  - Court may set Cashing Notice aside if:
    - circumstances do not allow recovery (ie, hearing de novo)
    - insufficient facts and circumstances in Proposal Notice
    - for Excess Contributions, bankrupt proves they were solvent in years 3 to 5 before the commencement of the bankruptcy
    - Net Earnings Notice is incorrect
  - Application before 28 days after Cashing Notice given to ST
- Proposal Notice
  - BT gives to bankrupt, member and ST
    - sets out the facts and circumstances entitling recovery
    - sets out an estimate of the Recoverable Amount, and an explanation of how the estimate was calculated

- 28 days to comment / agree to proposal
- Civil proceedings do not lie against a person for loss, damage or injury of ay kind suffered because of the giving of a Proposal Notice

- The Recoverable Amount
  - So much of value of superannuation interest as is attributable to:
    - excess contributions
    - but not allowable contributions
    - tainted contributions
    - the member's unallocated forfeited amount net earnings on those contributions / amounts

- Excess Contributions
  - Contribution to a superannuation fund; and
  - Bankrupt's fund, or spouse or child; and
  - No tax deduction for the contribution; and
  - Up to 5 years before the commencement of the bankruptcy; and
  - Not required under rules of the fund; and
  - Not a CGT exempt rollover amount; and
  - Not a transfer from a foreign fund; and
  - Not Allowable Contributions
  - Made after 16 December 2003

- Allowable Contributions
  - Up to $5,000 in Excess Contributions protected from recovery
  - BT must identify in an Allowable Contributions notice

- Tainted Contributions

- Contribution by bankrupt or employer
- To bankrupt, spouse or child
- Would have become available to creditors
- Main purpose was to defeat interests of creditors (as for s.121)
- May be inferred from bankrupt's insolvency

- Unallocated forfeited amount
  - Amount member has forfeited to the fund
    - but not accrued to any other member of the fund
  - Counts towards the member's recoverable contributions
- Net Earnings
  - Only if recoverable contributions exceed $50,000
  - BT may calculate earnings on recoverable contributions
  - Must have reasonable grounds to believe correct
  - Must have regard to any disclosed earnings rate by ST
  - BT may give a Net Earnings Notice to bankrupt, member and ST (evidence of fund earnings)
  - Query whether Net Earnings should be recoverable?
- Limitation Periods
  - Excess contributions
    - 6 years after date of bankruptcy
  - Tainted contributions
    - At any time
- Freezing Notice
  - OR may give Freezing Notice to the ST

        - Copy to bankrupt and member

    - ST may not rollover or cash benefits except with agreement of OR

    - Lasts for 180 days

        - OR may extend period if OR has reasonable grounds to believe Cashing Notice may be given

    - ST not liable for loss suffered by any person because of anything done (or not done) by ST in good faith in reliance on Freezing Notice.

- Information Gathering

    - BT has reasonable grounds to suspect ST holds benefits for bankrupt, spouse or child

    - BT may require ST to complete an approved form about the member's benefits

- Tracing of Contributions

    - The new Part will allow the BT to trace a recoverable contribution (and earnings) through:

        - a roll-over of the benefits

        - a family law payment split

    - Applies a proportionate approach

- Reductions in Recoverable Amount

    - Recoverable amount reduced by:

        - benefits cashed as a pension or lump sum

        - any consideration provided by the spouse or child