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Legalwise: Family Law Drafting Intensive
MELBOURNE – 13 September 2019

UNDERSTANDING THE ELEMENTS OF A BINDING FINANCIAL AGREEMENT: STEPS TO PRECISION DRAFTING

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INTRODUCTION

Any solicitor drafting a financial agreement should use their best endeavours to ensure that the agreement is:

1. binding – in accordance with section 90G (in the case of a financial agreement between married parties) or section 90UJ (in the case of a financial agreement between de facto partners) of the *Family Law Act 1975* (Cth) ("Act"); and

2. drafted in a way that reduces the risk of the agreement being set aside in accordance with section 90K (in the case of married parties) or section 90UM (in the case of de facto partners) of the Act.

This paper will address some tips and traps in drafting financial agreements including:

1. How to improve the likelihood that the agreement will be upheld by a court

2. Tips and traps when drafting the letter of advice

3. When is the court likely to set aside a financial agreement?

    (a) Disclosure – to disclose or not to disclose?

    (b) Fairness – does a financial agreement need to be fair?

4. Tips for reducing the risk that the agreement may be set aside

5. Key clauses to include when drafting financial agreements

6. Case Study

It is important to note at the outset that the suggestions outlined in this paper relate primarily to financial agreements prior to separation, meaning those made under section 90B (before marriage or in contemplation of a marriage), section 90C (during marriage but prior to separation), section 90UB (before de facto relationship) or section 90UC (during a de facto relationship) of the Act. It is those agreements which are at most risk of being set aside by a court when the parties have separated and it no longer suits one of the parties to have their claim for property settlement or spousal maintenance limited or extinguished by the terms of the financial agreement.

Although some principles may also be applied to financial agreements drafted post separation, meaning those under section 90C (during a marriage but post separation), 90D (after a divorce) or 90UD (after the breakdown of a de facto relationship) of the Act, it is acknowledged that such agreements are less common.

Where possible, we suggest that you consider utilising court orders to formalise any agreement reached by parties post separation given that orders do not carry the same risks of being set aside or varied as a financial agreement.

HOW TO IMPROVE THE LIKELIHOOD THAT THE AGREEMENT WILL BE UPHELD BY A COURT

It appears that most cases setting aside financial agreements pursuant to section 90G or section 90UJ are as a result of simple errors on the part of the solicitor drafting the agreement or providing advice in relation to the agreement.

Some examples of errors which have led to the setting aside of a financial agreement include the following:

- Including the wrong party names.
- Referring to the wrong section of the Act – e.g. is it a section 90B Agreement or a 90C Agreement?

  Although a reference to the wrong section of the Act within the agreement may be rectified, incorrectly referencing the wrong section of the Act may lead to advice being given under the wrong section which cannot be rectified.
- Incorrect drafting or form of the Statement of Independent Legal Advice.

Some drafting tips for avoiding these sorts of errors and therefore reducing the risk of having the agreement found to not be binding are:

1. Ensure that you do not act for both parties. Make it clear which party you act for by confirming who you are and are not acting for.
2. Ensure the wording of the agreement and Statement of Independent Legal Advice reflects the requirements of section 90G/s90UJ.
3. Ensure that you update your precedents to ensure compliance with amendments to the Act. In the case of *Gardiner & Baker* [2009] FMCAfam 1029 the statement of legal advice utilised wording of the former section 90G and omitted the word “disadvantages” which was fatal to the agreement.
4. Have another lawyer read over the draft agreement ‘with fresh eyes’ to pick up any obvious errors.
5. Retain a certified copy, if not the original, of the executed agreement on file together with a copy of the letter of advice with an acknowledgment of advice signed by the client to ensure you have evidence that the requirements of section 90G/90UJ were complied with.

TIPS AND TRAPS WHEN DRAFTING THE LETTER OF ADVICE

Under section 90G(1)(b) and 90UJ(b) of the Act, in order for a financial agreement to be binding each party to the agreement must have been provided with independent legal advice from a legal practitioner about the effect of the agreement on the rights of that party and about the advantages and disadvantages, at the time the advice was provided, to that party of making the agreement.

It is important that practitioners ensure that their client is competently advised in relation to the financial agreement including the risks of entering into the agreement. In the

decision of *Cording & Oster* [2010] FamCA 511 Justice Cronin at paragraph 58 discussed the Full Court decision of *Kostres and Kostres* [2009] FamCAFC 222 in relation to the onus on the legal advisor:

> *In* Kostres*, the Full Court noted that the legislature had been careful to include strict requirements if a financial agreement was to be binding including the requirement of independent legal advice. The Full Court went on to say it was clear that the legislature envisaged, because of the nature of the agreement and the removal of the supervisory role of the Court, that parties would receive legal advice about the necessity for their intentions to be accurately and clearly reflected in the agreement. The Full Court was focussing on the importance of parties getting legal advice prior to the execution of the agreement because the advice would be expected to cover a myriad of issues. The advice referred to in s 90UJ(1)(b) refers to the effect of the agreement on the rights of that party and about the advantages and disadvantages of entering in the agreement. As the Full Court said, the object of the legislation is to remove the supervisory role of the Court.* ***The onus therefore reverts to the legal advisor, as an issue of the advantages and disadvantages for the client, to contemplate whether disclosure has been made comprehensively and sufficiently to justify that client entering into the agreement.***
>
> (emphasis added)

To assist practitioners in complying with these sections of the Act we suggest the following be consulted as a guide:

1. The advice should be given in writing. It is not sufficient to provide verbal advice to a client without specific details of what advice was given. A letter of advice should therefore be provided to the client as long-term evidence of the advice that was given.

2. The letter of advice should be prepared once the terms of the agreement have been finalised. i.e. your advice must be referrable to the final version of the agreement – if the agreement is amended, the letter of advice will also need to be amended prior to execution.

3. The letter of advice should be issued to the client prior to their attendance at your office to execute the agreement allowing sufficient time for them to digest the contents of the letter and ask you any questions before they sign the agreement.

4. The letter of advice should clearly state that you cannot guarantee that the agreement will be upheld by a court if the other party were to seek to have the agreement set aside.

5. The letter of advice should explain:

   (a) The section 90G/90UJ requirements for an agreement to be binding.

   (b) The effect of the agreement on the client's rights, including reference to any provision made in the agreement for property settlement and/or spousal maintenance.

(c) The grounds on which a party could seek the financial agreement be set aside pursuant to section 90K/90UM. Any grounds of particular relevance to a party's circumstances should be identified and advice should be given as to how to mitigate such risk including any suggested changes to the terms of the financial agreement.

(d) The advantages and disadvantages to a party of entering into the agreement.

6. It is not sufficient to merely state in the letter that you provided the requisite advice to the client verbally in conference.

7. The letter of advice should include an acknowledgement of receipt of advice by the client in the wording of section 90G/90UJ. The client should be required to sign the acknowledgement after you have discussed any questions they might have and prior to executing the agreement.

   Example

   "I received independent legal advice from my lawyer about the effect of the agreement on my rights and about the advantages and disadvantages, at the time that the advice was provided, of making the agreement.

8. The advice should be specific to the parties' circumstances and the terms of the agreement. This advice should include a comparison of the party's entitlement under the agreement and otherwise at law having regard to how a court deals with property applications under section 79/90SM of the Act. A "cookie cutter" template letter of advice as to the advantages and disadvantages of financial agreements generally is unlikely to provide advice to the standard that is required.

9. Ensure that the letter of advice is in plain English.

10. Have the letter of advice translated into your client's native tongue if English is not their first language.

The use of the wording "binding financial agreement" which is often used by practitioners, means that clients may be under the disillusion that the agreement cannot be set aside.

To avoid clients making any assertion that they were unaware that an agreement may be set aside in the future and accusing the lawyer who drafted it of failing to inform them of this, ensure this is addressed clearly in your letter of advice.

Ultimately if you are of the view that the disadvantages outweigh the advantages and that the client should not sign the financial agreement, this should be set out clearly within the letter of advice.

WHEN IS THE COURT LIKELY TO SET ASIDE A FINANCIAL AGREEMENT?

Section 90K (in the case of financial agreements between married parties) and section 90UM (in the case of financial agreements between de facto parties) of the Act set out the circumstances in which a court may set aside a financial agreement.

Considering the circumstances set out in section 90K/90UM, practitioners drafting or advising in relation to, a financial agreement should have particular regard to:

1. Whether either party has engaged in fraud, including non-disclosure of a material matter.

2. Whether either party has engaged in conduct which would render the Agreement void, voidable or unenforceable having regard to the general common law and equitable principles of contract relating to vitiating factors.

3. Circumstances which are likely to arise in future which may render the terms of the agreement impracticable.

As the provisions of section 90K(1)(e)/90UM(1)(e) of the Act invoke the principles of equity as factors vitiating the agreement, practitioners should have regard to any circumstances which may resemble duress, undue influence or unconscionability. Practitioners should be equipped to advise their client in relation to these issues and how to best mitigate the risk of the agreement being set aside on one of these bases.

To disclose or not to disclose?

Sections 90K(1)(a)/90UM(1)(a) of the Act provide that the court may set aside a financial agreement if the court is satisfied that the agreement has been obtained by fraud (including non-disclosure of a material matter).

This leads to the question of whether a party is required (or should) give disclosure of their financial position when entering into a financial agreement. And, if so, to what extent a party is required to give disclosure of their financial position to best prevent the setting aside of a financial agreement in accordance with paragraph 90K(1)(a) or 90UM(1)(a).

There are ultimately two schools of thought when negotiating and drafting a financial agreement.

1. The first approach is that you ought provide the other party with, at the very least, some disclosure so that they have at least a general idea of the composition and value of the assets held by the party whom is in the financially stronger position. However, on one view providing only minimal disclosure may in fact increase the risk that the agreement will be set aside on the basis that the party provided disclosure <u>but still</u> failed to disclose a material fact.

2. The second approach is to provide no estimates of the value of that party's interest in those company or trusts, perhaps only listing the companies and trusts in which they have an interest, and to provide no financial documents which would enable the other party to attribute a value or obtain an expert valuation in relation to the other party's interests.

In relation to the issue of the extent to which a party is required to disclose their financial position for the purpose of a financial agreement, the Full Court in the decision of *Kennedy & Thorne* [2016] FamCAFC 189 noted:

> *the obligation of parties to provide full and frank disclosure in financial proceedings occurs in a context where a court is required to make findings about the assets,*

> *liabilities and financial resources of the parties, and where the court is also required to be satisfied that it is just and equitable to make orders*

In contrast, the Full Court stated that:

> *a financial agreement is a private contract between parties into which there is no express statutory requirement that disclosure be made or valuations be obtained and that such an agreement is capable of being binding, with little or no knowledge of the other party's financial position*

That being said, the more fully a party to a financial agreement discloses their financial position, the lower the risk of that agreement being set aside on the basis of non-disclosure of a material fact.

Recitals regarding disclosure

The issue of disclosure can be addressed in the body of the financial agreement using detailed recitals. Some examples of recitals that address disclosure are as follows:

Examples of recitals

1. Each party relies upon their personal knowledge of the affairs of the other party.

2. The Agreement has been reached by compromise.

3. Jane is the owner of, or potentially has an entitlement to, the Property and Entities, and has the financial resources and liabilities, described in Schedule A hereto.

4. In relation to Schedule A, Jane confirms: -

   (a) it accurately discloses the identity, nature and estimated value of her present and potential Property, Entities, financial resources and liabilities as at the date of this Agreement;

   (b) the estimate of values referred to therein is indicative and her best estimate;

   (c) the Entities listed in parts 1 and 3 of Schedule A are those which exist at the date of this Agreement.

5. Jane may also be entitled to inheritances or gifts of which she is presently unaware, and the parties intend that such inheritances and gifts shall be Excluded Property.

6. John acknowledges that Jane's financial position, including her financial resources, has been disclosed to his satisfaction.

7. Jane is the owner of, or potentially has an entitlement to, the Property and Entities, and has the financial resources and liabilities, described in Schedule A hereto.

8. In relation to Schedule A, Jane confirms: -

   (a) it accurately discloses the identity, nature and estimated value of her present and potential Property, Entities, financial resources and liabilities as at the date of this Agreement;

(b) the estimate of values referred to therein is indicative and her best estimate;

(c) the Entities listed in parts 1 and 3 of Schedule A are those which exist at the date of this Agreement.

9. John may also be entitled to inheritances or gifts of which he is presently unaware, and the parties intend that such inheritances and gifts shall be Excluded Property.

10. Jane acknowledges that John's financial position, including his financial resources, has been disclosed to her satisfaction.

11. Jane and John acknowledge that they have not independently assessed the value of the other's Property, Entities, financial resources and liabilities, and acknowledge that, although they have each had the opportunity of valuing same, they have elected not to do so.

12. Each party acknowledges that they have not undertaken due diligence, although they acknowledge that they were at liberty to do so and they have elected not to do so.

Fairness – does a Financial Agreement need to be fair?

As stated above, a party may be successful in an application to set aside a financial agreement on the basis that it is found to be void, voidable or unconscionable. This principal invokes common law and equitable principles as factors vitiating the agreement.

Simply because one of the parties made a bad bargain does not mean that it would be unconscionable for the other party to enforce the agreement. The agreement does not need to be just and equitable and generally, one party is disadvantaged by entering the financial agreement having regard to their likely entitlements at law.

However, the High Court decision of *Thorne v Kennedy* gives some suggestion that practitioners may wish to counsel any client seeking to enter into an agreement which would render one party grossly disadvantaged.

A financial agreement which makes a reasonable provision for the financially disadvantaged party may be less likely to be considered the subject of unconscionable conduct or undue influence.

TIPS FOR REDUCING THE RISK THAT THE AGREEMENT MAY BE SET ASIDE

Practitioners drafting financial agreements should know how to identify a "red flag", being circumstances that would greatly increase the risk of having the agreement set aside.

Some key tips to practitioners drafting agreements to reduce the risk of having an agreement set aside include:

1. Avoid "ink on the tuxedo" or "ink on the wedding dress" cases which carry increased risks that a party will allege undue influence or duress due to the proximity of the wedding.

2. Parties to a financial agreement should have time to properly contemplate and negotiate the terms of the agreement.

3. As agreements can be set aside on the basis of circumstances arising that render them impracticable, practitioners should have regard to any foreseeable future circumstances when drafting the agreement and when advising their client.

   For example - are the parties planning on having children? What happens if an asset referred to in the agreement is sold?

4. Be conscious of any client who wants the agreement drafted “quickly” or “cheaply”. The client needs to be made aware of the risks involved in a financial agreement being set aside and appreciate that the process takes time and is costly.

5. Be wary of a party expecting that they can receive comprehensive drafting of the agreement from you but send the other party to a “cheap” lawyer to get the requisite advice to keep costs down. It is important that both parties attend upon lawyers who are experienced in family law and financial agreements, such as an Accredited Family Law Specialist.

   If you are unsure about any aspect of the financial agreement or your advice to your client, consider briefing specialist counsel to provide advice in relation to the agreement.

6. The practitioner advising the other party should be contacted by yourself or their intended client. Ensure that your client does not contact or initiate the appointment on the other parties’ behalf.

7. Discuss with your client the risks associated with placing pressure on the other party. It is best practice to ensure that your client is essentially leaving any conversations about the agreement to be had by lawyers to avoid any influence or pressure being exerted.

8. Carefully check the agreement to ensure it complies with your client’s instructions. In particular, review the schedules and road test any formulas.

KEY CLAUSES IN FINANCIAL AGREEMENTS

Whilst each agreement will be individual to the cases, there are certain clauses which practitioners may consider including in order to minimise the risk of the financial agreement being set aside in future as a result of the drafting.

These key clauses include:

1. How joint property will be dealt with upon separation. Some considerations are:

   (a) Which party will vacate the home.

   (b) Who will be responsible for the outgoings of property post separation.

   (c) Valuation of real property to determine fair market value.

(d) Terms of sale.

(e) How the net proceeds of sale will be distributed.

Examples

(i) In accordance with legal ownership.

(ii) In accordance with a specified percentage.

(iii) In accordance with financial contributions.

(iv) Another option is to simply exclude separate property and otherwise the parties agree that their respective entitlements in respect of joint property will be determined pursuant to the Act.

Note - if you leave it for the court to determine, the court is required to consider pursuant to section 75(2) and section 79(2) the separate property each party will retain in accordance with the financial agreement. You may therefore wish to include provision for the parties to instruct an arbitrator to determine the issue not having any regard to the separate property which each party will retain.

2. Exclude each party's separate property. Determine what this will include and how any tracing of the sale proceeds of separate property will be conducted or calculated. Separate property may include:

(a) Pre-relationship assets or liabilities.

(b) Property acquired in substitution for a pre-relationship asset.

(c) Gifts and inheritances received during the relationship, including any income received and any increase in their value.

(d) Property acquired in one party's sole name subsequent to the date of the agreement.

3. Superannuation – ensure there are clauses determining how superannuation will be dealt with in the event of separation.

(a) Ensure that procedural fairness to the Trustee of the Superannuation Fund (even if a self-managed superannuation fund) is accounted for.

Example

"Having been accorded procedural fairness, the provisions of this agreement are binding on Hemsworth & Cyrus Investments Pty Ltd CAN 123 456 789 ("Trustee") as trustee of the Hemsworth Cyrus Superannuation Fund ("Fund")"

4. Spousal Maintenance - consider how any spousal maintenance will be calculated and paid. This may include payments during the relationship as well as post separation.

(a) Note section 90E of the Act – a provision of a financial agreement that relates to the maintenance of a spouse party to the agreement or a child or children is void unless the provision specifies:

(i) The party, or the child or children, for whose maintenance provision is made; and

(ii) The amount provided for, or the value of the proportion of the relevant property attributable to, the maintenance of the party, or of the child or each child, as the case may be.

(b) Having regard to section 90E include a dollar amount. E.g. $10,000 for one party and $10,000 for the other party with the amounts to offset each other.

(c) Some practitioners prefer a "dollar for dollar" agreement. In *Ruane & Bachman Ruane* [2009] FamCA however, Cronin J considered the question of whether an agreement that provides for "nil" spousal maintenance complies with section 90E was not relevant to the proceedings for him but was a question for "*another day*".

(d) You may wish to annexe a table or formula which sets out the calculation of maintenance.

5. Separation payment -

(a) Consider whether one party will make a payment to the other party upon separation and if so, the quantum of that payment or a formula for the calculation of that payment.

(b) For the purpose of a separation payment, you may wish to include a sliding scale of cash payments to the financially inferior party which increases based upon years of marriage and/or birth of children to the marriage.

(c) Have regard to the timeframe of any payment and any condition relating to the payment. For example, the separation payment may be paid upon a party vacating a home, or upon the passing of a certain timeframe post separation.

6. Schedules of the parties' "joint property" and "separate property"

(a) These schedules should include:

(i) Real property.

(ii) Share portfolios.

(iii) Cash in bank accounts.

(iv) Vehicles.

(v) Superannuation entitlements.

(vi) Interests in trusts and companies.

(b) At the very least these items should be listed. However, ideally, estimated or formal values should be provided for all items of property including any interests in trusts and companies.

(c) If a financial agreement is drafted on the basis that the parties will be precluded from having an interest in any inheritance of the other party, and the anticipated inheritance of one or both parties is significant, you may wish to include an estimated value of that inheritance if known.

7. Statement of Independent Legal Advice by each party's lawyer and Acknowledgment by the client that they received the advice

(a) It is important to note that the Statement of Independent Legal Advice should be noted as same and not referred to as a "certificate". The *Federal Justice System Amendment (Efficiency Measures) Act (No 1) 2009 (Cth)* made it clear that this is the correct wording.

8. Separation declaration in accordance with section 90DA of the Act.

(a) Note that a separation declaration is not required if the financial agreement relates only to spousal maintenance.

(b) Ensure that "separation" for the purposes of the implementation of the agreement is defined as being linked to the service or deliverance of the separation declaration.

CASE STUDY

1. Donald comes to you for advice. He advises he has separated from his wife of 8 years with whom he has one 5-year-old son. He presents you with a short and simple BFA which excludes the $2 million high rise apartment which Donald has held with his sister as joint proprietors for 15 years and in which he lived with his wife Melania during the marriage as Donald's "separate property". Donald advises you that he and his sister each contributed one half to the purchase price and mortgage which was repaid in full prior to Donald's marriage to Melania. Since their marriage, Donald has met all utilities in full. Donald and his sister have each contributed one half to the house insurance, rates and repairs to the property.

2. The agreement provides for Melania to receive a payment of $50,000 from Donald and otherwise retain her share portfolio ($100,000), car and superannuation.

3. Melania denies having ever signed the agreement or receiving legal advice about the agreement, notwithstanding that it appears to have been signed by her. She says she only remembers Donald taking her to see his lawyer ten days before the wedding. She says she signed a document in the presence of Donald and his lawyer and didn't understand what she was signing. Melania asserts that Donald had told her that if she did not sign the document, the wedding would not proceed.

4. The lawyer who appears to have signed the Statement of Legal Advice for Melania produces her file. Her file contains a detailed letter of advice in which she recommends against Melania signing the agreement on the basis that it is unfair to her, particularly if the parties were to have children, but noting Melania's

instructions that she wishes to enter into the agreement notwithstanding her lawyers' advice. Also on file is a copy of the agreement signed by Melania and Melania's lawyer but not by Donald or his lawyer. Donald recalls that Melania provided him with the signed agreement and that he thereafter attended his lawyers' office to execute the agreement, later providing Melania with a copy of the fully executed agreement. The signatures on the fully-executed agreement produced by Donald are in a different location to those on the agreement produced by Melania's lawyer.

5. Melania instructs you that the parties were married three weeks later in an intimate ceremony in the high-rise apartment with ten of their nearest and dearest family members and friends as their only guests. She has been the primary carer of the parties' son and currently only works two shifts per week at a call centre.

How would you advise Donald of the risks that the agreement will be set aside?