

HUNTER VALLEY FAMILY LAW SEMINAR

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FOR RICHER, FOR POORER – FINANCIAL AGREEMENTS UNDER THE FAMILY LAW ACT

**by Ian Kennedy AM
Senior Partner
Kennedy Wisewoulds
Melbourne
ian.kennedy@wfl.com.au**

Part VIIIA of the *Family Law Act 1975* permits parties to enter into agreements either in anticipation of, during, or upon the breakdown of their marriage. . However it didn't happen overnight, and indeed the process took some 13 years from initial recommendations made by the Australian Law Reform Commission in 1987 through to the commencement of the new legislation on 27 December 2000.

WHY CONTRACT?

Australian society has altered radically in the 30 years or so since the *Family Law Act 1975* was enacted. This period of history has been characterised by major societal changes including:

- Significant attitudinal changes to marriage throughout the broader community.
- A high and increasing rate of marriage breakdown.
- Falling marriage rates.
- An increasing incidence of couples cohabiting in marriage-like relationships although not formally married.
- Higher rates of second and subsequent marriages.

Further, throughout that period, the various Australian States and Territories have progressively enacted legislation in relation to cohabiting (including, in most instances, same-sex) couples which deal with the division of their property interests on relationship breakdown, and either enable them to enter into binding agreements regulating their financial affairs or recognise such agreements. This created the extraordinary anomaly that the rights

of married couples with respect to self-regulation of their financial affairs were significantly less than those of cohabiting couples.

These factors led to a build-up of significant pressure for change. The Joint Select Committee on Certain Aspects of the Operation and Interpretation of the Family Law Act, in its November 1992 report to Commonwealth Parliament, considered the desirability of the wider use of pre-marital and marital contracts. Of the 62 submissions which it received dealing specifically with pre-marital agreements only two were against such a mechanism, and the JSC endorsed the concept of pre- and post-marital agreements being legally recognisable and enforceable documents.

These forces were recognised by the then Attorney-General in his Second Reading speech introducing the Bill containing the new provisions in 1999:

“The changes in this Bill will attempt to bring the Act into line with prevailing community attitudes and needs”.

Those attitudes and needs reflected a demand for self-regulation arising from:

- The desire of parties entering into, living in or terminating a marriage to make their own arrangements for ownership and management of their property, income and financial resources both during and/or at the end of their relationship.
- A desire for increased certainty in the event that the relationship came to an end.
- The avoidance of conflict between them in relation to financial matters both during and after their relationship.
- The avoidance of the expense and delay of litigation and the uncertainty of outcome (the “judicial lottery”).
- The ability to protect assets held prior to the commencement of the relationship or acquired during it by inheritance or otherwise through specific individual means independent of the marriage partnership.

Self regulation was regarded by many as particularly important in a range of circumstances including:

- ◆ In second or subsequent marriages for the protection of previously-owned assets for the benefit of the children of previous marriages.

- ◆ For the preservation of multi-generational farming properties or long-established family businesses.
- ◆ Where there was a significant disparity of wealth of the parties or the anticipated wealth of one of them by way of eventual inheritance.
- ◆ For parties from cultural backgrounds where marriage agreements are commonly-accepted practice.
- ◆ To avoid family disputes on the death of a party to a second or subsequent marriage (which for many couples is a particularly important consideration).

For all of these reasons many couples see considerable benefits in entering into an agreement to regulate the financial aspects of their marriage – and now have the option to do so.

THE LEGISLATION

Under Part VIII A of the *Family Law Act 1975* couples may enter into financial agreements either before marriage (s90B), during marriage (s90C) and after dissolution (s90D).

Section 90B permits couples who are contemplating marriage to make a written agreement between themselves in relation to:

- How their property and financial resources (whether owned at the time of the agreement or acquired later) are to be dealt with in the event of marriage breakdown.
- The maintenance of either of them and/or their children during the marriage and/or upon its termination.

Section 90C enables similar agreements in the course of a marriage (either before or after breakdown) and s90D makes provision for agreements post-dissolution.

The effect of such an agreement is to oust the jurisdiction of the Court in relation to the matters covered in the agreement.

In his Second Reading speech the Attorney-General identified the aim of such agreements as being to encourage people to agree about how their matrimonial property should be distributed in the event of, or following, separation:

“Agreements will allow people to have greater control and choice over their own

affairs in the event of marital breakdown. Financial agreements will be able to deal with all or any of the parties' property and financial resources and also maintenance. An agreement may cover how property would be divided, or how maintenance would be paid. Particular assets, such as rural properties, would be able to be preserved."

He also noted that binding financial agreements "*will be of particular benefit to people who are entering into subsequent marriages as well as to people on the land and those who own family businesses*".

For a financial agreement to be binding and become effective it must comply with certain formalities set out in s90G and 90DA of the Act, and in particular must:

- (a) be specified to be made under the appropriate section of the Act.
- (b) be signed by both parties.
- (c) contain in relation to each party a statement to the effect that that party has been provided, before the agreement was signed, with independent legal advice as to:
 - (i) the effect of the agreement on the rights of that party;
 - (ii) the advantages and disadvantages, at the time that the advice was provided, to the party of making the agreement.
- (d) have certificates of independent legal advice for each party attached to it.
- (e) be activated by a written separation declaration complying with s90DA.

Financial agreements continue in force and effect notwithstanding the death of a party and are binding on the legal personal representative: s90H. An agreement may only be terminated by another agreement complying with all of the same formalities as apply to the initial entry into the agreement (s90H) or by the Court setting it aside (s90K).

JURISDICTION OF COURTS

Although the intention of the legislation is to remove the discretionary jurisdiction of the courts in relation to property division and maintenance to the extent that those issues are validly covered by a financial agreement, they nonetheless retain jurisdiction in a number of areas.

First of all, no provision in a financial agreement can exclude or limit the power of a court to make an order in relation to the maintenance of a party if the court is satisfied that, when the agreement came into effect, the circumstances of that party were such that, taking into account the terms and effect of the agreement, the party would have been unable to support himself or herself without an income-tested pension, allowance or benefit: s90F(1A). Pre-nuptial agreements were initially exempt from this revenue-saving provision but legislation has now been enacted to close that loophole. Further, provisions relating to maintenance of a party or a child are void unless they specify:

- (a) The party or child for whom the provision is made; and
- (b) The amount provided for, or the value of the relevant property attributable to, the maintenance of the party or child.

Secondly, any assets which do not come within the provisions of the agreement remain available for adjustment by the court between the parties in the exercise of the broad, discretion-based property division powers under s79 (4) of the *Family Law Act*. Many agreements are designed only to preserve pre-marriage or inherited assets and do not attempt to regulate the division of assets acquired in the course of the marriage by the parties through their mutual endeavours – and the Court is left at large in determining the proper division of those assets.

Thirdly, the Court retains power under s90K of the legislation to set aside a financial agreement if it is satisfied *inter alia* that:

- The agreement of a party was obtained by fraud (including non-disclosure of a material matter).
- The agreement is void, voidable or unenforceable.
- Circumstances have arisen since the agreement was made which make it impracticable for it to be carried out in whole or part.
- Since the making of the agreement there has been a material change in circumstances relating to the care, welfare and development of the child of the marriage and – as a result of the change – the child or the party with caring responsibility will suffer hardship if the agreement is not set aside.
- A party to the agreement engaged in conduct that was unconscionable in respect of the making of the agreement.

The question of whether a financial agreement is valid, enforceable or effective is to be determined according to the principles of law and equity applicable to determination of the validity, enforceability and effect of contracts and purported contracts (opening up the whole of the law of contract and equity); and in determining these issues the courts have the same powers, and may grant the same remedies, as the High Court of Australia in its original jurisdiction: s90KA.

Finally, following amendments enacted in December 2003 [s90K(1)(aa)], the Family Court has power to set aside an agreement on the application of a third party creditor where the agreement was entered into:

- For the purpose, or for purposes that included the purpose, of defrauding or defeating a creditor or creditors of a party; or
- With reckless disregard to the interests of a creditor or creditors of a party.

For that purpose “creditor” includes a person who could reasonably be foreseen by a party as being reasonably likely to become a creditor of that party.

The Family Court also has power to enforce agreements. Whether or not that power is an exclusive power, or whether agreements may be enforced in any court competent to deal with matters of contract and equity, is yet to be determined.

SUMMARY OF LEGISLATION

In summary, with respect to financial agreements:

- The legislation enables parties to enter into an agreement governing their financial relationship prior to, in the course of or at the end of marriage.
- Such agreements can cover:
 - Division of property and resources (whether existing or acquired in the future).
 - Maintenance for:
 - a party; and/or
 - children.
- A financial agreement must be:
 - In writing.
 - Signed by both parties.

- Specified to be made under the legislation.
- Have annexed to it certificates of independent legal advice.

- A written separation declaration is required to enable it to become effective.
- Financial agreements can be terminated by:
 - A further agreement.
 - An order of the Court.

- Courts cannot make orders in relation to:
 - Property and resources covered by the agreement.
 - Maintenance (where included) unless a party cannot support himself or herself without an income-tested pension, allowance or benefit.

- The courts retain jurisdiction in relation to:
 - The discretionary adjustment of property and resources not covered by the agreement.
 - Maintenance (unless validly covered by the agreement).
 - Setting aside agreements.
 - Determination of the validity and effect of agreements.
 - Enforcement.
 - Applications by third party creditors.

- Subject to complying with the formal requirements and not being set aside by a court, financial agreements are binding.

PRACTICAL CONSIDERATIONS

The legislation is no more than a starting point. There are many practical considerations which affect the content and enforceability of an agreement, and indeed whether the parties will enter it at all.

Emotional resistance

The period leading up to a marriage can be emotionally fraught at the best of times. The overlay of – and negotiations concerning – a pre-nuptial agreement can increase the emotional temperature greatly. Very often one party – who already has an asset base or expectations – wants the agreement. The other party may, however, consider it unnecessary or offensive, an affront to their integrity and/or a signal that their intended spouse is putting

financial considerations ahead of their personal relationship. This can make the process of negotiating an agreement extremely difficult for all concerned. In some cases, after initial steps, the agreement simply falls by the wayside. In others, the wedding itself is called off if the negotiations fail.

Duress and unconscionability

Agreements can be set aside by the Court where they are void or voidable – or where a party has engaged in unconscionable conduct in respect of the making of the agreement.

An agreement is voidable if entered into under duress – and probably if its terms are unconscionable. It can certainly be set aside if the circumstances of its making amounted to unconscionable conduct. It follows that care needs to be taken to ensure that both parties enter into the agreement freely and voluntarily and that there is no suggestion of undue pressure (for example, one party demanding that the other sign the agreement immediately prior to the marriage or else the wedding will not go ahead). There is no specified “cooling off” period, but for safety there should be no suggestion of undue influence.

Proportionality

Human affairs are complex – and that complexity is compounded infinitely when drafters try to predict the future. A pre-nuptial agreement is probably one of the most important documents that a client will enter into and requires considerable thought, careful advice, often extended negotiation (with various drafts) and time. The stakes need to justify the expense involved to the parties. There are practitioners who offer a “one size fits all” pro forma agreement at modest cost; but there are enormous risks in that approach, and the negotiation and drafting of a proper agreement is a costly exercise.

Disclosure

Agreements can be set aside for fraud (which is defined as including non-disclosure of a material matter). It follows that full and frank disclosure of all relevant matters – and in particular the financial circumstances of the parties – is fundamental if an agreement is to survive challenge. It is usual to append schedules of the assets, resources and liabilities of each of the parties to the agreement – and for the agreement to provide what should happen in relation to those items in the event of the marriage breaking down.

Fairness

The legislation does not specifically require that an agreement is fair. However if it is challenged and is patently unfair to one of the parties, it is highly likely that the court will be keen to set it aside if at all possible – and to that end has available to it all of the law of contract and equity. It is accordingly in the interests of both parties – and in particular the party most seeking to rely on the agreement – that its terms are realistic and reasonable.

Uncertainty

None of us has a crystal ball. No one can predict what will happen in life – particularly to a young couple starting out in their first marriage. Apparently secure employment may evaporate; parties may suffer chronic ill health; established fortunes may disappear due to ill luck or poor judgment; apparent maintenance needs may be overtaken by an unexpected windfall; the arrival of children may bring about fundamental changes. As a result, pre-nuptial agreements are of comparatively little use to young couples with few assets – and where they are entered into they are often expressed to operate only for a specified number of years or until the birth of the children (after which they are to be reviewed). However they are of considerably greater practical benefit for couples entering into a second marriage – especially where they do not intend to have children – where the contingencies can be better identified and provided for.

Lifestyle issues

Questions are often asked about whether agreements can or should contain lifestyle provisions. In general the answer is, no. The purpose of such agreements is to regulate the financial affairs of the parties. Although such provisions would not be offensive to the legislation (sub-paragraph (3) of each of the enabling sections makes it clear that agreements may contain incidental or ancillary matters) they are not enforceable and not in accordance with the intention of the legislation.

Professional indemnity issues

Lawyers drafting a pre-nuptial agreement are being asked to look into the future and take account of all foreseeable contingencies. That is a difficult enough task in itself. However it also carries with it the risk of a claim being made if the professional has overlooked something or the drafting is imperfect. Such a claim would not become apparent until the

marriage breaks down and a party seeks to rely on or avoid the agreement – which may be many, many years in the future.

In a number of United States jurisdictions (including New York and California) – as in Australia – pre-nuptial agreements which are validly entered into with legal advice on both sides, proper disclosure of financial matters and which are not tainted by fraud, are enforceable. However lawyers in the United States are becoming increasingly nervous about drafting such agreements, as pre-nuptial agreements themselves are leading to a significant amount of litigation. As Californian attorney Woody Mosten described in a paper to the 2000 Queensland Family Law conference:

“Each agreement that is tested in Court often ends up in a malpractice suit against the lawyer(s) who originally drafted them. If the agreement is affirmed, the dissatisfied party often seeks redress against the original lawyer because the Court sticks that party with the terms of the agreement. If the Court overturns the agreement, the party relying on the agreement for finality and enforceability may sue his lawyer for defective workmanship.

Family Lawyers are so skittish about signing on for an indefinite contingent liability that many just won't draft them. Others will draft them and sign their approval only if paid a very high non-refundable signing bonus – often on top of their high hourly rates ... The exposure of Family Lawyers is even greater than since the statute of limitations does not begin to run when the agreement is signed – the statute is tolled until one year after discovery of the professional negligence – this could be 10 – 20 years down the road.”

Although clients in Australia are not as litigious in the United States, this is an issue which needs to be considered by lawyers when asked to draft pre-nuptial agreements.

Similar concerns arise for lawyers who are asked to provide legal advice with regard to an agreement. Practitioners need to be very cautious about how they approach this, and it is difficult to see how such advice can safely be given without the practitioner having very full instructions and all financial information available.

This area has the potential to be a professional indemnity minefield – and considerable care needs to be exercised by any professional drawing or advising on a pre-nuptial agreement.