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FINANCIAL AGREEMENTS AND ESTATE PLANNING

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Pt VIIIA of the *Family Law Act 1975* allows parties to resolve property and spousal maintenance issues using a financial agreement which has not been ratified by a Court. The agreement is binding on the parties provided the requirements of s 90G are met.

When Pt VIIIA was introduced in December 2000, most writers concentrated their energy and speculation on pre-nuptial agreements. The ability of parties to make financial agreements before they married which would be binding in the event of their separation was an exciting initiative.

There are few reported judgments on applications to set financial agreements aside. Rare examples are *ASIC v Rich and Others* (2003) FLC 93-171 and *Black and Black* [2006] FamCA 972.

In the absence of reported cases where a financially weaker party has been successful in setting aside a financial agreement under s 90K, it is easy to be lulled into a false sense of security. Without knowing what will constitute duress under s 90K(1)(b), unconscionable conduct under s 90K(1)(b) or (e) or non-disclosure of a material matter under s 90K(1)(a), it is impossible to advise clients with absolute certainty. The ability to apply to set aside a financial agreement due to a material change in circumstances relating to the care of a child (s 90K(1)(d)) and the restrictions on contracting out of spousal maintenance rights imposed by s 90F are further barriers to lawyers giving confident advice about the ability of the pre-nuptial agreement to withstand attack.

Financial agreements have been particularly useful for separated couples (s 90C or 90D) for splitting superannuation and contracting out of spousal maintenance in certain circumstances. Since 12 December 2006, transfers under financial agreements have attracted CGT relief. The absence of CGT rollover relief before that date meant that financial agreements were often unsuitable for resolving all property issues between parties after separation.

The future of financial agreements for separating couples, if s 90F is not an issue in the circumstances, seems assured.

Pre-nuptial agreements

There is greater uncertainty about the future of financial agreements into by parties before a marriage or after a marriage but before separation.

Anecdotally, pre-nuptial agreements seem to be most popular, both amongst legal practitioners and clients, for parties who are older, often one or both have been married and

they often have children. A major incentive to enter into a financial agreement is to protect assets for the children of the prior relationship. Sometimes, the pressure to have a financial agreement comes from the children. Understandably, legal practitioners feel more comfortable dealing with this type of client. The young couple who has never been married before seems to be a much bigger risk. There are unusually insufficient assets at the start of the relationship to give adequate and fair provision for a financially weaker spouse who may at the end of the marriage be the primary caregiver of the children of the marriage and have been out of the workforce for several years.

Couples marrying later in life or for a second or third time seem less risky. Having been married or in lengthy relationships before, they know from experience that marriages don't always last. There are more assets to distribute. The parties themselves know more about their rights and obligations.

Is this sense of comfort appropriate? Probably not. Although the rate of marriage breakdown is higher for second and third marriages, many of these clients consider that the relationship is just as likely, or even more likely, to be terminated by the death of one of the parties than by separation. Whether or not this accurately assesses the risks is irrelevant. Client concerns about death must be addressed.

Effect of death on a financial agreement

Usually a financial agreement includes a provision that it is binding upon each party's heirs, executors, administrators and assigns. This is encouraged by s 90H. Section 90H provides:

A financial agreement that is binding on the parties to the agreement continues to operate despite the death of a party to the agreement and operates in favour of, and is binding on, the legal personal representative of that party.

If the death of one of the parties occurs before the financial agreement has taken effect, s 90H will not make the agreement operate in favour of, and be binding upon, the legal personal representative of the deceased. A financial agreement is only enforced against the estate if the agreement was binding on the deceased party before their death. The problem is most likely to arise in relation to a pre-nuptial agreement or agreement made during marriage but before separation. The requirements are:

- the marriage must have taken place
- there must have been a separation
- a separation declaration must be signed by one of the parties

Section 90DA(1) states:

A financial agreement between 2 people, to the extent to which it deals with:

(a) how, in the event of the breakdown of the marriage, all or any of the property or financial resources of either or both of them at the time when the agreement is made, or at a later time and before the termination of the marriage by divorce, is to be dealt with; or

(b) the maintenance of either of them after the termination of the marriage by divorce; is of no force or effect until a separation declaration is made.

The declaration must state that:

(a) the parties have separated and are living separately and apart at the declaration time; and

(b) in the opinion of the parties making the declaration, there is no reasonable likelihood of cohabitation being resumed. (s 90DA(4))

Section 90DA(4) suggests that a separation declaration cannot be signed after the death of one party, even if the parties separated before the death of one of them.

The precise effect of s 90H is unclear. The intention appears to be that all the provisions in a financial agreement are binding if one party dies even if the agreement does not specifically set this out. There is considerable doubt about the extent to which s 90H is effective. The effect of its predecessor for s 87 maintenance agreements, s 87(10), was never clear. Problems with both provisions include:

- Is a provision setting out what occurs if a party dies within the definition of "matrimonial cause" in s 4(1) *Family Law Act*?
- Is such a provision constitutionally valid? Does it fall within the Commonwealth's powers in s 51 of the Constitution to make laws with respect to:
 - (xxi) *Marriage;*
 - (xxii) *Divorce and matrimonial causes, and in relation thereto: parental rights and the custody and guardianship of infants.*
- To what extent can the Commonwealth legislate with respect to events after the death of one or both parties?
- Is there a conflict between s 90H (and s 87(10)) and state-based legislation with respect to the making of wills, distribution of deceased estates, probate and testator's family maintenance legislation?

Section 87(10) applies if one or both parties died and covers the following circumstances:

- A periodic maintenance provision can be binding on the payer's estate if the payer dies. The agreement must specifically provide that this is the case.
- A periodic maintenance provision cannot continue after the death of the payee even if the agreement provides that it does.
- Obligations, other than for periodic spousal maintenance, are usually binding on the estate of a deceased party.
- An agreement may expressly provide that obligations, other than for periodic spousal maintenance are not binding on the estate of a deceased party.

In certain circumstances the parties can agree that the effect of death differs from the presumptions in s 87(10).

Section 90H does not expressly say that parties can include provisions in an agreement which override s 90H. There appear to be two possibilities. Either:

- It is so obvious that the parties can contract out of the effects of s 90H that it is unnecessary to specifically provide for it; or
- Not providing expressly for the parties to contract out of s 90H, when s 87(10) does so, indicates that it is not possible to do so.

Some of these issues were considered in *Smith and Smith* (1984) FLC ¶91-525, *Smith and Smith (No 2)* (1985) FLC ¶91-604 and *Smith and Smith (No 3)* (1986) FLC ¶91-732. The basic issue in these cases was whether the Family Court could approve a s 87 maintenance agreement which included a release under s 31 *Family Provision Act 1982* (NSW).

The High Court said in *Smith and Smith (No 3)* (at p 75,340):

Clearly it is a matter arising under the State Act, and the fact that the Family Court may, under the Commonwealth Act, approve a maintenance agreement which includes releases in respect of claims under the State Act does not lead to the conclusion that an application for approval of a release, as contemplated by the State Act, is a matter arising under the Commonwealth Act, when the different criteria involved in each approval are properly borne in mind. Although the provisions of the Family Law Act relating to the jurisdiction of the Family Court and of the State Supreme Courts do not appear to have been thought through, it is inconceivable that Parliament intended to exclude from the Supreme Court of a State the jurisdiction to entertain an application arising under State law for approval of a release.

Contracting out of testator's family maintenance claims

If one or both parties have children from a prior relationship the parties may be at least as interested in protecting their assets if they die as if they separate. Depending on the parties' ages and states of health, they may think that their relationship is more likely to end due to the death of one of the parties than marriage breakdown. The enforceability of provisions excluding the rights of parties to make testator's family maintenance claims may be a significant issue.

In Victoria, Pt IV *Administration and Probate Act 1958* allows the Supreme Court to order that provision be made out of the estate of a deceased person for the proper maintenance and support of a person for whom the deceased had responsibility to make provision (s 91(1)).

Factors to consider include:

- (e) *any family or other relationship between the deceased person and the applicant, including the nature of the relationship and, where relevant, the length of the relationship;*
- (f) *any obligations or responsibilities of the deceased person to the applicant, any other applicant and the beneficiaries of the estate;*
- (g) *the size and nature of the estate of the deceased person and any charges and liabilities to which the estate is subject;*
- (h) *the financial resources (including earning capacity) and the financial needs of the applicant, of any other applicant and of any beneficiary of the estate at the time of the hearing and for the foreseeable future;*
- (i) *any physical, mental or intellectual disability of any applicant or any beneficiary of the estate;*
- (j) *the age of the applicant;*
- (k) *any contribution (not for adequate consideration) of the applicant to building up the estate or to the welfare of the deceased or the family of the deceased;*
- (l) *any benefits previously given by the deceased person to any applicant or to any beneficiary;*
- (m) *whether the applicant was being maintained by the deceased person before that person's death either wholly or partly and, where the Court considers it relevant, the extent to which and the basis upon which the deceased had assumed that responsibility; ...*

Testator's family maintenance claims may not be precluded by s 79 orders or a financial agreement, even if there is no ongoing spousal maintenance. The overall circumstances will be relevant.

In New South Wales, unlike Victoria, parties are able to contract out of testator's family maintenance claims by obtaining a release under s 31 *Family Provision Act 1982 (NSW)*. A clause can be included in a financial agreement which absolutely prohibits, subject to Supreme Court approval, a claim under testator's family maintenance legislation. In other states it can only be a non-binding statement of intention.

Proposals have been floated for the States and Territories to have uniform succession laws.¹ The proposals include the ability to obtain releases under testator's family maintenance legislation. It may be worthwhile to include a provision that the ability to obtain a release becomes part of the law of Victoria, the parties will apply for a release. The wording of such a provision is problematic and it may be unenforceable.

The usual approach of the Courts in New South Wales² to the approval of releases under s 31 where there has been a property settlement under s 79 *Family Law Act* was addressed in *McMahon v McMahon* (NSWSC, Young J, 2 August 1985). The Court said that an order approving the release did not follow automatically from a clause in a s 87 maintenance agreement in which the parties agreed to seek a release. The Court still had to look into the facts and circumstances so far as they were relevant to a possible claim under the *Family Provision Act*.

In *Gallagher v Gallagher* (NSWSC, 3 April 1984), Master Gressier had a similar view:

Clearly the approval under s 87 is a circumstance to which I should have regard in the present proceedings. On the other hand, it is not, in my view, a circumstance which leads inevitably to the giving of the approval now sought. The Family Court was concerned with the respective and present financial positions of two living persons between whom there were various financial matters in dispute. This Court is concerned, in effect, with the position of the defendant in some unknown time in the future if, and only if, she survives the plaintiff. The task of this Court is, to that extent, more difficult than that of the Family Court. Evidence cannot establish what the defendant's financial position will then be or, indeed, what the plaintiff's then testamentary obligations and financial position will be. ...

Having regard to the facts that the parties have been separated for some twelve years and that the plaintiff has been remarried for some six years, and to my assessment, in the light of present circumstances, of the defendant's likely chances of success in any application under the Act in relation to the estate of the plaintiff, I am satisfied that the orders sought should be made.

¹ National Committee for Uniform Succession Laws, Queensland Law Reform Commission

² Justice Paul Brereton of the Supreme Court of New South Wales, 'Where Death & Divorce Meet: The Intersection of Family Law Provision & Family Law', Paper given at the 12th National Family Law Conference 2006. This section of the paper relies in part on His Honour's paper.

In *Ridley v Ridley* (NSWSC, Young J, 13 December 1988), Young J said:

The principle that has been adopted under s 31 is that if the parties have each been properly advised and have considered all the pros and cons and have voluntarily reached an arm's length settlement, ordinarily it is appropriate to make an order under s 31 of the Family Provision Act.

In New South Wales the practice is often to obtain agreement to a s 31 release in consent orders or financial agreements, but not apply for Supreme Court approval of the release. Any necessary application is made after the death. This has risks. The Court is not bound to give the release and the eligible person can change their mind. An example of this occurred in *Russell v Quinton* [2000] NSWSC 322. De facto partners entered into a cohabitation agreement which included a s 31 release. No application was made for its approval until after the death of the male partner. The female partner brought an application for provision out of his estate, and the executor cross-claimed for approval of the release. It emerged that the female partner had been given incorrect advice as to the effect of the cohabitation agreement, and in particular that it only operated for five years. Mainly for that reason, Bergin J declined to approve the release and made orders for further provision for the female partner out of the deceased male partner's estate.

Alternatives to contracting out of spousal maintenance

There are at least three other ways in which testator's family maintenance claims can be avoided. The first and simplest is to ensure that the spouse is appropriately provided for in the will. The second method is a contract for mutual wills which is discussed further below. The third method is *inter vivos* transactions. This usually involves setting up trusts. There are frequently stamp duty and capital gains tax considerations which make this an impractical solution. More detailed discussion of the latter alternative is beyond the scope of this paper.

Mutual Wills

Parties can enter into an agreement setting out the entitlements of each party if the other dies. The consideration for the contract is the mutual wills which detail these entitlements. Ideally, the contract should be in writing, although conduct may be sufficient. These provisions could, arguably, be included in a financial agreement as an "ancillary" matter. More properly, and for convenience of drafting, they should be in a separate agreement. Mutual wills are not identical wills. The two testators create two wills. They enter into a contract by which each testator undertakes not to revoke their will without notice to the other. The wills need not be identical.

A contract for mutual wills imposes on the surviving party an obligation enforceable in

equity. A promise to leave a mutual will does not usually prevent non-testamentary (*inter vivos*) dispositions during the life of the surviving party. Remarriage of the surviving party revokes a mutual will. A contract for mutual wills may exclude after acquired assets (so that these can still be devised on other children, relatives, future spouse etc) or try to limit *inter-vivos* dispositions. The effectiveness of mutual wills is limited.

For many years the leading case was *Birmingham v Renfrew* (1937) 57 CLR 666. Dixon J said (at p 682):

The contract bound him, I think, during her lifetime not to revoke his will without notice to her. If she died without altering her will, then he was bound after her death not to revoke his will at all. She on her part afforded the consideration for his promise by making her will. His obligation not to revoke his will during her life without notice to her is to be implied. For I think the express promise should be understood as meaning that if she died leaving her will unrevoked then he would not revoke his. But the agreement really assumes that neither party will alter his or her will without the knowledge of the other. It has long been established that a contract between persons to make corresponding wills gives rise to equitable obligations when one acts on the faith of such an agreement and dies leaving his will unrevoked so that the other takes property under its dispositions. It operates to impose upon the survivor an obligation regarding as specifically enforceable. It is true that he cannot be compelled to make and leave unrevoked a testamentary document and if he dies leaving a last will containing provisions inconsistent with his agreement it is never the less valid as a testamentary act. But the doctrine of equity attach the obligation to the property. The effect is, I think, that the survivor becomes a constructive trustee and the terms of the trust are those of the Will which he undertook would be his last will.

More recently, the concept of mutual wills has been challenged. It was thought that the original beneficiaries could still enforce a trust arising from a revoked mutual will. This was, of course, subject to there not having been *inter vivos* dispositions. *Barnes v Barnes* (2003) HCA 9 (7 March 2003) was an appeal from the Full Court of the Supreme Court of South Australia. The High Court found that the agreement for mutual wills did not prevent the assets of the deceased from being available to be considered in the context of a testator's family maintenance claim.

In *Barnes*, the purpose of the agreement for mutual wills was to prevent a daughter from making a claim pursuant to the South Australian testator's family maintenance provisions. The couple left their entire estate to the son without any provision being made for their daughter.

The High Court found that the contract to make mutual wills did not operate as a debt due to the estate by each of the parties. After the death of the father an irrevocable floating trust did not arise, as previously thought, over all of the assets that would crystallize on the death of the mother as a trust in favour of the son. The father's estate had performed its obligations under

the deed. The father had made a will in the terms required by the agreement. No trust was created between the father and mother or son that affected the father's estate. The assets of the father's estate were inherited by the mother and were available to be considered in any claim for maintenance and support brought by the daughter.

Section 79 rights after death

When looking at death and financial agreements it is relevant to compare the effect of death on s 79 proceedings and s 79 orders. The right to bring proceedings under s 79 for a property settlement is purely a personal right. If parties to a marriage separate, but one of them dies before proceedings for a property settlement have been commenced, the surviving spouse cannot commence proceedings against the deceased person's estate.

However, if proceedings under s 79 have already commenced and one of the party dies, then the proceedings can be continued by the substitution of the deceased's legal personal representative.

Section 79(8) provides that:

Where, before proceedings with respect to the property of the parties to a marriage or either of them are completed, either party to the proceedings dies -

- (a) *the proceedings may be continued by or against, as the case may be, the legal personal representative of the deceased party and the applicable Rules of Court may make provision in relation to the substitution of the legal personal representative as a party to the proceedings;*
- (b) *if the court is of the opinion -*
 - (i) *that it would have made an order with respect to property if the deceased party had not died; and*
 - (ii) *that it is still appropriate to make an order with respect to property, the court may make such order as it considers appropriate with respect to any of the property of the parties to the marriage or either of them; and*
- (c) *an order made by the court pursuant to paragraph (b) may be enforced on behalf of, or against, as the case may be, the estate of the deceased party.*

The (non-binding) *Explanatory Guide* to the *Family Law Rules* defines legal personal representative as "*the executor or administrator of the party's estate*".

It is sufficient for proceedings to have been issued for s 79(8) to become operative. Service of the proceedings before death is not required (*Mason v Mason c/o Hannaford; Mason-King* (1994) FLC 92-446).

Procedurally, the proceedings are effectively suspended until an order substituting the legal

personal representative has been made. Pursuant to r 6.15 *Family Law Rules* if a party dies, the other party or the legal personal representative of the deceased party, must ask the court for procedural orders in relation to the future conduct of the case. Once a substitution order is made, the power to make a property settlement order is slightly different from the power that would have existed had the deceased spouse remained alive. Under s 79(8), before making a property settlement order the court must be of the opinion:

- (a) that it would have made a property settlement order if the deceased party had not died; and
- (b) that it is still appropriate to make a property settlement order.

Some of the facts which may be relevant for the court to consider in deciding whether it is still appropriate to make an order are:

- (a) whether the surviving spouse benefits under the will of the deceased or otherwise as a result of the deceased's death (for instance, if the surviving spouse was the beneficiary of a death benefit payable from the deceased party's superannuation entitlements)
- (b) the deceased may have had significant needs while they were alive, but those needs no longer exist

Certain matters are not relevant:

- (a) The Court is not entitled to take into account the claims of the beneficiaries of a deceased's estate (*Mason v Hannaford*; *Mason-King Intervenor* (1993) FLC 92-398);
- (b) The Court must not have regard to the potential claim of the surviving spouse under testator's family maintenance legislation.

A s 79 order can be enforced by the surviving party against the estate of the deceased or can be enforced by the estate of the deceased party against the surviving party (s 79(1A) and s 79(8)(c)). Section 79A(1)(c) similarly provides for the continuation of s 79A proceedings against the estate of a deceased party.

Long term ill-health or incapacity and separate residences

Most proceedings for a property settlement rely upon the definition of "matrimonial cause" in

s 4(1)(ca)(i). The parties are usually separated but not divorced and the property proceedings arise out of the marital relationship. It is not absolutely necessary for the parties to have separated prior to the commencement of s 79 proceedings. Provided the proceedings between the parties with respect to property "arise out of the marital relationship", there does not technically need to be a separation. However, the Court may be reluctant to make orders for a final property settlement if the parties have not separated.

The case of *Jennings (by his next friend State Trustees Ltd) v Jennings* (1997) FLC 92-773 is an interesting illustration of when the Court might decline to exercise its discretion to make a s 79 order. At the time of the hearing the husband was 73, had been hospitalised for 3 years and was likely to remain in hospital for the rest of his life. He had suffered from alzheimers and other health problems for 9 years. The wife was 70 and lived in a property she owned before the marriage. The wife cared for the husband at home until 1994. Between the time of his hospitalisation and the time of the hearing, the wife visited the husband on a regular basis in hospital.

State Trustees was appointed as administrator of the husband's affairs in late 1994 at the request of the wife's son from a previous marriage. State Trustees, as next friend of the husband, issued an application for a property settlement. The wife sought that the application be struck out, or in the alternative, stayed until separation had taken place.

State Trustees conceded that the wife had never formed an intention to separate from the husband and that the husband had never given any instructions to the effect that the marriage was over. State Trustees decided of its own accord that the parties were separated.

Justice Dessau found that the powers of the Administrator pursuant to the *Guardianship and Administrative Board Act (Vic)*:

preclude a conclusion that the Administrator is able to form the intent to sever the represented persons marriage ... It strikes me as a perverse proposition that an Administrator, appointed to represent a person who through disability is unable to organise his own affairs, could simply 'reach a decision' that the person's marriage has ended ... In my view the Administrator is empowered to handle the legal and financial affairs of a party but cannot possibly be empowered to handle 'the affairs of the heart' or the most intimate aspects of the represented persons mind and sole.

Her Honour concluded that separation had not occurred. Both parties conceded that the jurisdiction to make an order was within the definition of matrimonial cause in s 4(1)(ca)(i). The wife submitted that although the jurisdiction existed, the Court should not exercise its

jurisdiction because:

- (a) the Court should seek to protect, rather than promote the end of the parties' marriage;
- (b) until the parties separated, the Court could not properly consider the respective contributions made by the parties pursuant to s 79, a final property order could not properly or fairly be made as the marriage was ongoing, and there were limited opportunities for the parties to later seek to set aside any property order made.

Her Honour agreed, finding that:

orders finally determining the property issues between [the parties] could not be appropriate, fair or just ... in circumstances where the parties have informed no intention to separate, one is suffering illness and is hospitalised and the other continues to visit and partake in his care to the extent that she is able.

An unreported decision of the Full Court of the Family Court, *Sterling* (2000), had similar facts to *Jennings*. The parties were married for 43 years. The wife suffered from alzheimer's and was cared for by her husband until his own ill health prevented him from caring for her. She went into a nursing home but he visited her there. The Protective Commissioner for the State of NSW was appointed to manage the wife's financial affairs and applied to the Family Court for a property settlement.

The trial Judge found that:

a complete and final physical separation had been forced on the parties by the tragic circumstances of the wife's illness even though the marriage had not irretrievably broken down within the meaning of the Family Law Act, there were no attributes of normal married life.

It was just and equitable to make an order for property adjustment.

The trial Judge's decision was upheld by a majority of 2-1 in the Full Court, although the majority found that neither the trial Judge in *Jennings* or *Sterling* was in error as a matter of law. There was a very strong dissenting judgment by Kay J who said:

Marriage is not seen to be an institution that is entered into during such time as the health of the parties enables them to live together.

Spousal maintenance

The best way to protect against future spousal maintenance claims in a financial agreement is to ensure that the property retained by or transferred to the possible maintenance claimant is sufficient for that party not to be eligible for Centrelink benefits and has sufficient to support themselves.

Section 90E states that a provision of a financial agreement that relates to the maintenance of a party to the agreement or a child or children is void unless the provision specifies:

- (a) *the party, or the child or children, for whose maintenance provision is made; and*
- (b) *the amount provided for, or the value of the portion of the relevant property attributable to, the maintenance of the party, or of the child or each child, as the case may be.*

The ability of parties to contract out of spousal maintenance or oust spousal maintenance rights was restricted retrospectively by the introduction of s 90F(1A) in December 2003.

Under s 90F(1), a financial agreement cannot exclude or limit the power of a court to make an order in relation to the maintenance of a party to a marriage:

if the court is satisfied that, when the agreement came into effect, the circumstances of the party were such that, taking into account the terms and effect of the agreement, the party was unable to support himself or herself without an income tested pension, allowance or benefit.

Conclusion

Financial agreements do not provide a simple solution to estate planning. They are not a replacement for wills although parties may mistakenly believe they are. Section 90H has uncertain effect but it is clear from the Act, particularly since the insertion of s 90DA, that if the financial agreement has not taken effect, s 90H does not make the provisions of the agreement enforceable.

A party who is concerned to protect assets from claims by the other spouse in the event of their own death, needs to ensure an appropriate will and perhaps consider other options such as mutual wills and *inter vivos* dispositions.

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