

Australian Law Reform Commission
Review of the Family Law System—Issues Paper (IP 48)
Submission of Written Evidence

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Summary

1. This submission focuses on the legal principles in relation to parenting and property, specifically the area of binding financial agreements (BFAs).
2. This submission responds to question 19 in the Issues Paper (IP 48):

‘What changes could be made to the provisions in the Family Law Act governing binding financial agreements to improve the clarity and comprehensibility of the law for parties and to promote fair outcomes?’

Background to the Author of the Submission

3. The author is a Senior Lecturer in Law at Cardiff University and is author of several publications on BFAs, with particular focus on prenuptial agreements. These include the book *Prenuptial Agreements and the Presumption of Free Choice*¹ which was shortlisted for three major book prizes and was cited and applied by the High Court of Australia in *Thorne v Kennedy*.² This work was also cited by the Law Commission of England and Wales in its report on marital property agreements.³

The use of BFAs to the disadvantage of the member of the couple in the weaker bargaining position

4. There is almost always inequality of power between parties entering financial agreements. One party will usually want an agreement more than the other. An agreement may not accurately reflect the wishes of both parties. More often than not, such an agreement is created *because* there is inequality of bargaining power.

¹S Thompson, *Prenuptial Agreements and the Presumption of Free Choice* (Hart 2015)

²[2017] HCA 49. See also S Thompson, ‘*Thorne v Kennedy*: Why Australia's decision on prenups is important for English law’ (2018) 48 *Family Law* 415-419.

³Law Commission, *Matrimonial Property, Needs and Agreements* (2014) Report no. 343.

Furthermore, the course of marriage and family life can create dependency in a way that may not be anticipated by the terms of a BFA. So even if the parties begin their marriage as financially independent individuals, this is frequently not the case at the end of the marriage. Whilst matters sometimes work out as planned in the BFA, this should not detract from the fact that commonly, particularly in longer marriages, matters do change.

5. The dependencies that emerge during married life are likely to be gendered. Career sacrifices tend to be made by the wife when children are born, which might not have been provided for in a financial agreement. Domestic work (such as child care and housework) is gendered, and so more women than men give up financial independence to fulfil these roles. This is reflected in recent statistics, as the 2016 census shows Australian women do more unpaid domestic work than men.⁴ This has clear economic repercussions too; as an Australian Parliamentary report shows, one in three Australian women retire with nothing in their superannuation.⁵
6. In addition, there are often gendered power issues when a financial agreement is created, as the non-moneyed spouse is more likely to be the woman and the moneyed spouse is more likely to be the man. Taking English caselaw as an example, this can be broken down further when looking at the source of wealth. In most English cases where the moneyed spouse is the wife, the source of the wealth is her family.⁶ In most English cases where the moneyed spouse is the husband, the source of the wealth is his career. 'Career wealth' is different from 'family wealth' because it is possible for a party to generate 'career wealth' over the course of a marriage while their partner sacrifices their own career to support the family. A BFA may protect the enhanced earning capacity of the moneyed spouse without compensating the non-moneyed spouse's career sacrifices that contributed to such enhanced earnings.

⁴ Australian Bureau of Statistics, at <http://www.abs.gov.au/websitedbs/D3310114.nsf/home/2016+Census+National>.

⁵ Economics References Committee, *'A husband is not a retirement plan' Achieving economic security for women in retirement*, April 2016, at https://www.aph.gov.au/Parliamentary_Business/Committees/Senate/Economics/Economic_security_for_women_in_retirement/Report.

⁶ *Radmacher v Granatino* [2010] UKSC 42; *Luckwell v Limata* [2014] EWHC 1035 (Fam).

7. The issues with this gendered division are exacerbated further given that the non-moneyed spouse tends to have less leverage when negotiating the terms of a BFA, especially if that spouse has no particular desire for a BFA to be signed.
8. One solution to this could be to not enforce financial agreements at all. But this would take power away from couples for whom it is important to determine financial matters in the event of relationship breakdown. As a result, other solutions must be explored.
9. *Prenuptial Agreements and the Presumption of Free Choice* is based in part on a study of New York practitioners' experiences of nuptial agreements since the 1980s.⁷ Each attorney interviewed for this study believed prenuptial agreements tended to be conceived on an unlevel playing field and consequently said they take deliberate steps to ensure not only that an agreement is fair when made, but also that it will not later become unconscionable.
10. In addition to considerations of timing, independent legal advice and full financial disclosure, New York attorneys advocated the insertion of a 'sunset clause' when drafting a prenup. The effect of a sunset clause is that once a defined period of time has elapsed, the award to the non-moneyed spouse increases, or alternatively the prenup is no longer enforceable. Several attorneys felt that this clause represented a compromise between the parties, as the non-moneyed spouse will not waive his or her equitable distribution rights if the marriage lasts, yet the moneyed spouse's assets are protected in the short term. Other attorneys, however, preferred to avoid the insertion of sunset clauses, as they had been involved in multiple cases where the moneyed spouse ended the marriage before the clause came into effect. Indeed, one attorney felt that the true effect of sunset clauses is to cause spouses to re-evaluate their marriage and think about divorce.
11. New York attorneys also admitted to 'working the system' when representing the non-moneyed spouse on divorce. In their experience, attorney said that the moneyed spouse is usually more willing to increase the share of assets to the non-moneyed

⁷ For a summary of the findings of this study S Thompson, *Prenuptial Agreements and the Presumption of Free Choice* (Hart 2015), chapter 3, and S Thompson, 'Levelling the prenuptial playing field: Is independent legal advice the answer?' (2011) 4 *International Family Law* 327-331.

spouse on divorce if it means avoiding the expensive threat of litigation. In effect, the non-moneyed spouse often has some leverage on divorce to seek a little more than he or she would receive under the agreement, but attorneys emphasised that the award will clearly not be as much as they would get if there was no agreement at all. Thus, the bargaining power in this situation hinges on the threat of litigation costs to the moneyed spouse, as there is rarely any threat that the court would vary or set aside an agreement, or order equitable distribution to be paid to the non-moneyed spouse. A moneyed spouse unwilling to adjust the terms of the agreement will decide to face the risk of litigation, and in these situations, it is the non-moneyed spouse who must pay if unsuccessful in his or her challenge.

12. New York attorneys also said they would take steps during the drafting process to improve an agreement for the non-moneyed spouse or make it less one-sided. While these efforts might assist the interests of both parties, it does not necessarily mean there is a level playing field. Nevertheless, one attorney described how he would attempt to iron out inequalities as much as possible:

‘A good prenup, the one I did today actually, had good benefits for both parties. Yes, it doesn’t give the wife nearly as much as she might get if the parties did not have an agreement, but it guarantees a certain level.’

In this scenario, the non-moneyed spouse’s lawyer can at least prevent her from entering an agreement that would preclude any entitlement to her spouse’s assets on divorce.

13. However, requiring lawyers to make adjustments for their clients similar to the attorneys discussed above does not ensure fairness in a jurisdiction where financial agreements are binding. It creates a situation where fairness depends on the knowledge, expertise and insight of individual lawyers. Future legislative reform must therefore continue to acknowledge the endemic power imbalances in financial agreements.

14. This could be achieved by following the recommendations of the American Law Institute (ALI), which put forward reform proposals in the United States aiming

recognise both issues of power and parties' choice.⁸ For instance, the ALI has suggested that a prenup may be varied or set aside when it would lead to substantial injustice. When assessing the meaning of 'substantial injustice' and whether it has occurred, the ALI has set out a number of tests. First, it is recommended that a judge would have discretion to consider whether there has been substantial injustice only if the party resisting enforcement can show that one or more of the following has occurred since the agreement was created:

- (a) more than a fixed number of years have passed, that number being set in a rule of state-wide application;
- (b) a child was born to, or adopted by, the parties, who at the time of execution had no children in common;
- (c) there has been a change in circumstances that has a substantial impact on the parties or their children, but when they executed the agreement the parties probably did not anticipate either the change, or its impact.

15. Point (c) is of particular significance, as any unanticipated change in circumstances may be considered by the court, as long as the impact on the parties is 'substantial'. Once one of these situations is proved to have occurred, the judge must consider whether enforcing the prenup in question would lead to substantial injustice. As 'substantial injustice' is a vague term, the ALI set out the following guide to matters to be taken into account, so that the judge's discretion would be more principled:

- (a) the magnitude of the disparity between the outcome under the agreement and the outcome under otherwise prevailing legal principles;
- (b) for those marriages of limited duration in which it is practical to ascertain, the difference between the circumstances of the objecting party if the agreement is enforced, and that party's likely circumstances had the marriage never taken place;
- (c) whether the purpose of the agreement was to benefit or protect the interests of third parties (such as children from a prior relationship), whether that

⁸ ALI, *Principles of the Law of Family Dissolution: Analysis and Recommendations* (LexisNexis 2002). See also the discussion in S Thompson, *Prenuptial Agreements and the Presumption of Free Choice* (Hart 2015), chapter 6.

purpose is still relevant, and whether the agreement's terms were reasonably designed to serve it;

(d) the impact of the agreement's enforcement upon the children of the parties.

16. The principled discretion suggested by the ALI could ameliorate some of Australian lawyers' concerns of when advising their clients about financial agreements. The ALI asserts that these provisions recognise the issues of power associated with BFAs and by proposing principled discretion, a level of certainty is also ensured. As a result, the approach of the ALI could provide a step forward when considering future legislative reform in Australia.

The extent to which the provisions governing binding financial agreements sit comfortably with a discretionary approach to property adjustment

17. The safeguards built into the Family Law Act 1975 undoubtedly contribute to a higher overall standard of fairness. Any future legislative reform must take into account the power imbalance that frequently affects financial agreements as outlined in the previous section.

18. Another issue inherent in BFAs is that they provide for future circumstances that are often impossible to predict. One of the most common change in circumstances is a change in lifestyle as a result of the increasing success of the moneyed spouse during the marriage. In these situations, the lesser income producing spouse could receive a relatively small percentage of this wealth under a financial agreement, having to scale down his or her lifestyle after separation. It is imperative that there is scope to take such changing circumstances into account at the time the financial agreement is given effect.

19. It is possible to reconcile the provisions governing BFAs with a discretionary approach to property adjustment if the court adopts a relational approach (as the High Court of Australia did in *Thorne v Kennedy*).⁹ This means considering the wider

⁹ I have developed this approach further in a theory I call Feminist Relational Contract Theory, or FRCT. See S Thompson, *Prenuptial Agreements and the Presumption of Free Choice* (Hart 2015), chapter 6.

context in which the financial agreement was signed. It should not be assumed that both parties have exercised autonomy in the signing of a financial agreement, as doing so serves to side-line contextual factors such as how and why the agreement was made. Assuming autonomy also means the question of *why* an individual would knowingly sign a bad agreement is not asked.

Whether and how family violence should be taken into account where a couple has entered into a financial agreement, including family violence that commenced after the financial agreement was finalised

20. It is imperative that family violence is taken into account where a couple has entered into a financial agreement, including family violence that commenced after the agreement was finalised. Ignoring such violence would also mean ignoring parties' changing intentions of over the course of the relationship, so that the financial agreement would only represent the parties' intentions in the discrete moment it was signed. Such an approach marginalises important context pertaining to the financial agreement. Indeed, understanding the way people make decisions and enter agreements is not based on the concept of an isolated rational individual. A richer understanding of financial agreements that pays attention to family violence and other relational inequalities does not force the court to choose between either respecting party autonomy or protecting those rendered economically vulnerable under an agreement. A deeper, more contextual enquiry enables the court to do both.

21. Financial agreements should not automatically be deemed unenforceable, but by adopting an alternative approach as suggested in my book,¹⁰ which views the intentions of the parties as developing over time, the focus is on the parties' relationship instead of the bargaining process at the time the agreement was signed. This approach considers conduct as evidence of party autonomy in the overall context of the relationship. The most obvious incidences would be where the parties change their careers, income, or deal with assets differently from the way anticipated by the agreement. But the focus of this approach would not be on these incidents per se; it

¹⁰ S Thompson, *Prenuptial Agreements and the Presumption of Free Choice* (Hart 2015), 182.

would be on how, for example, a career change had affected the parties' relationship with one another and their intentions regarding financial agreements.

22. In the United States there are cases that suggest that this approach could be effective in practice. In Oregon, in *Baxter v Baxter*,¹¹ the court held that the parties' mutual intentions had changed. The prenuptial agreement in this case specified that ownership of the parties' assets would remain separate during the first 13 years of their marriage, during the latter part of the marriage the wife left her job to work unpaid in her husband's business and paid off some of the business debt using her separate assets. Accordingly, variation was justified by the court.

23. When deciding the weight to be attached to financial agreements, there must be scope for the court to appreciate patterns of power and the lived realities of the parties to agreements, including family violence. This means ensuring that the provisions affecting financial agreements in the Family Law Act have the capacity to appreciate parties' changing circumstances after a financial agreement is signed. This is important if it is accepted that financial agreements are not only concerned with the maximisation of wealth. It must be ensured that the voices of those on the short end of power because of family violence or because of economic disadvantage incurred through care are not drowned out by those wishing to guarantee their assets will be protected.

The effect of the recent High Court decision *Thorne v Kennedy*, which set aside an agreement on the basis of unconscionable conduct, on enforceability of agreements

24. The High Court of Australia (HCA) in *Thorne v Kennedy* set aside a prenuptial and postnuptial agreement on the basis of undue influence and unconscionable conduct. In doing so, the court zoomed out of the discrete circumstances in which the financial agreements were signed to understand why the wife, Ms Thorne decided to sign. The prenup was signed only days before the wedding, the wife's family had travelled to Australia for the wedding and the wife would not be able to get a visa to stay in the country unless she married. This wider context enabled them to conclude that the wife

¹¹ 911 P 2d 343 (Oregon 1996).

did not make a free choice. The court noted a range of contextual factors which may have prominence:

‘(i) whether the agreement was offered on a basis that it was not subject to negotiation; (ii) the emotional circumstances in which the agreement was entered including any explicit or implicit threat to end a marriage or end an engagement; (iii) whether there was any time for careful reflection; (iv) the nature of the parties’ relationship; (v) the relative financial positions of the parties; and (vi) the independent advice that was received and whether there was time to reflect on that advice.’

These factors were pivotal in satisfying the HCA that there was undue influence and the decision of the Full Court should be overturned. For instance, this contextual view enabled the HCA to take the view that threats to end an engagement can be just as coercive as threats to end a marriage, citing and applying suggestions from my book.¹²

25. The HCA’s reasoning in *Thorne* arguably demonstrates a radical departure from the approach of other Australian courts. The HCA did not regard the decision to sign a nuptial agreement as a binary choice and focused on the context of the parties’ relationship instead of only on the contractual transaction at issue. Conversely, the Full Court was only concerned with whether the parties *consented*, reducing the question of free choice to an assessment of their competence to agree. This narrowly constrained idea of choice led to a view of Ms Thorne as a gender-neutral, atomised person, who could (but did not) insist on making the agreement better, or who could walk away from the engagement. And so it is unsurprising that the Full Court concluded her will was not overborne because she had received excellent legal advice and signed both agreements knowing their effect could be disastrous.

26. By contrast, the HCA asked whether *the wife* was under pressure within the constellation of relationships and circumstances *she* was experiencing. This led to the conclusion that Ms Thorne had no choice ‘as she saw it’ because ‘every bargaining

¹²S Thompson, *Prenuptial Agreements and the Presumption of Free Choice* (Hart 2015), 115.

chip and every power' was in Mr Kennedy's hands.¹³ Whilst the Full Court took factors such as the solicitor's recommendation not to sign as evidence that Ms Thorne was not subject to undue influence because she understood it was a bad agreement, the HCA moved beyond this factual assessment and asked instead *why* she would knowingly sign such a bad agreement. The 'significant gap'¹⁴ between Ms Thorne's actions and her lawyer's advice was considered by the court to be evidence of undue influence, as she would do anything to ensure the wedding would go ahead. This is an example of a shift away from the orthodox contractual approach adopted in the Full Court and in English case law, and follows the broader relational approach suggested in my work which was cited in the judgment. By taking a more expansive view of undue influence, the court can appreciate wider questions like why decisions are made in the context of nuptial agreements, or how power imbalances affect the parties involved.

27. The majority decision of the HCA represents a radical interpretation of undue influence, which was not favoured by the dissenting judges in this case or by academics commenting on the case to date. The dissent preferred to conclude that pursuant to the doctrine of unconscionable conduct, Ms Thorne was at a 'special disadvantage'; she could not rationally decide to protect her own interests and it was unconscionable for Mr Kennedy to take advantage of this.¹⁵ Gordon J argued that the threshold for undue influence was not met in this case because 'Ms Thorne's capacity to make an independent judgment was not affected'.¹⁶ It is regretful that yet again, this interpretation limits the question of undue influence to one of capacity, and a limited conception of choice. The majority were clear that one does not need to be an 'automaton'¹⁷ for their will to be overborne. Undue influence does not have to mean that an individual objectively has no alternative, but it is possible, as the majority in the HCA has shown, to understand whether that individual subjectively felt *she* had no alternative. As a result, the HCA's approach arguably bends orthodox understandings of 'free will' in contract to incorporate important context about the parties involved.

¹³*Thorne v Kennedy* [2017] HCA 49 (para 47).

¹⁴*Ibid.*, (para 56).

¹⁵*Ibid.*, (para 81).

¹⁶*Ibid.*, (para 80).

¹⁷*Ibid.*, (para 40).

28. Significantly, *Thorne v Kennedy* demonstrates the potential to expand equitable doctrines like undue influence by moving beyond the binary question of whether there was free consent or not and by considering other subtler indications of power imbalance, such as *why* insistent warnings against signing nuptial agreements are ignored. It was clear Ms Thorne did not think the agreement would ever come into effect. Her two options – sign or leave Australia – did not make her decision to sign a free choice. Had the playing field been equal, Ms Thorne could have had a third option: she could have made a mutually beneficial agreement. Being able to see this third way recognises that both protection of economic vulnerability *and* the promotion of agency are possible. If party autonomy is now the most important aspect of financial agreements, a richer understanding of how and why decisions are made and the effect of power imbalances on such decision making is critical. The HCA’s broader and richer understanding can provide inspiration to courts elsewhere showing how agreements can be assessed contextually, without resorting to a paternalistic approach that undermines individuals’ agency in practice.

LIST OF RELEVANT PUBLICATIONS

Thompson, S., (2018). *Thorne v Kennedy*: Why Australia's decision on prenups is important for English law. *Family Law* 48, pp. 415-419, free text available at: <http://orca.cf.ac.uk/110827/>.

Thompson, S., (2016). In defence of the 'gold digger'. *Oñati Socio-Legal Series* 6(6), pp. 1225-1248, available open access at: https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2887022.

Thompson, S., (2015). *Prenuptial agreements and the presumption of free choice: Issues of power in theory and practice*. Hart Publishing.

Thompson, S., (2011). Levelling the prenuptial playing field: Is independent legal advice the answer? *International Family Law* 4, pp. 327-331.