

## TAB 6

# Issues Facing Contracting Parties with Disparate Net Worth

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## **ISSUES FACING CONTRACTING PARTIES WITH DISPARATE NET WORTH**

by Suzette M. Blom

### **Introduction**

The Hartshorne case, (2004), SCC 22, 236 D.L.R. (4<sup>th</sup>) 193 (S.C.C.), has reinforced the Court's willingness to affirm the binding nature of agreements. However, parties should not consider that agreements are immune from challenge. In Hartshorne the Court held that in circumstances where the consequences of an agreement are within the reasonable contemplation of the parties at the time the agreement is made, and where they have made adequate arrangements in response to these anticipated consequences, the agreement will be binding. Also, the essential criteria of fairness and disclosure must be present in order for an agreement to be valid.

Parties with unequal resources begin the process with the appearance of inequality. It is therefore crucial that the agreement meet both the overall objectives of the Family Law Act and the common law elements of contract. In negotiating and drafting contracts for parties with disparate net worth, consideration must be given to creating a fair and sufficient bargain which is fully understood by all parties.

Marriage contracts are distinct from other forms of agreements, not only in the scope of their subject matter but because they are contracts of the “utmost good faith”.

Dubin v. Dubin 2003 Carswell Ont 534, 34 R.F.L. (5<sup>th</sup>) 227 (S.C.J.)

A corollary of this principle is the establishment of a fiduciary standard in bargaining for marriage contracts. This high standard is particularly applicable to parties with disparate net worth. Some of the issues involved in the standard are:

1. sufficiency of disclosure;
2. consideration;
3. fairness; and
4. clarity of understanding.

Both statutory grounds and common law grounds should be considered.

#### **a. Grounds Provided by Statute**

Statutory grounds for setting aside a contract under section 56 (4) of the Family Law Act provide as follows:

1. Failure to disclose significant assets or debts existing when the contract was made;

2. the parties inability to understand the nature or consequences of the domestic contract; and
3. otherwise in accordance with the law of contract.

The statute, by enumerating specific grounds (such as a failure to disclose or a party's inability to understand the nature or consequences of the contract) has given greater scope to the common law standard for setting aside a contract.

## **b. Disclosure**

### **i. “Material” v. “Significant”**

Subsection 56 (4) deals with the parties' failure to disclose significant assets, debts and other liabilities, existing at the date the contract was made.

Generally, a person seeking to set aside a contract on the basis of non-disclosure must provide that an omission was material and operative in the sense that if he or she had known the fact he or she would not have entered into the contract or would only have done so at a different level of consideration.

Brans v. Brans (1997) 28 R.F.L. [4<sup>th</sup>] 114 1997 Carswell Ont 1594 (O.C.A.)

The disclosure contemplated by section 56 (4) is far broader than disclosure at common law. At common law a contract is voidable if a party fails to disclose “material” facts relied on by the other party. It is of note that section 56 (4) uses



the word “significant”. Any failure to disclose “significant assets” may make the contract voidable whether or not the other party relied on that fact or was induced to enter the contract as a result of it.

The standard for marriage contracts may well be higher than the standard for other types of domestic contracts in respect of the issue of non-disclosure. In cases where parties have disparate net worth any failure to disclose may be seen as “significant” given the relative inequality of the parties’ positions.

## **ii. Mandatory Disclosure**

The statute is also clear that disclosure is not optional. Section 56 (7) provides that section 56 (4) will apply despite any agreement to the contrary. Thus the waiver of disclosure even by sophisticated parties to whom the disclosure may be irrelevant may still leave the contract open to attack. This principle is reinstated by the operation of section 56 (7). In circumstances where the parties may be perceived as being at different bargaining positions by virtue of their disparate net worth one of the methods leading to a “leveling of the playing field” is to ensure that adequate disclosure has taken place. Otherwise, parties in this position entering into a marriage contract will undoubtedly be caught by the operation of these sections.

Counsel acting for parties in these circumstances must reinforce the requirement for disclosure with both clients and opposing parties. It must be clear that the lack of a request for disclosure will not protect the validity of the contract.

### **iii. Purposes of Disclosure - Defining Assets**

Disclosure also facilitates the drafting of the regime to be established by the contract. Proper disclosure will assist in setting out with accuracy the assets to be affected by the contract and the “cost” to the opposing party. It is only with this understanding that a contract will meet the standard and survive any attack.

Marriage contracts often establish schemes which expand either the category of exclusions or deductions for the purpose of calculating net worth. Disclosure of assets assists in defining what may be the regime established by the contract.

In summary, the effects of section 56 (7) and 56 (4) are to create a clear duty that every party must make complete, fair and frank disclosure of all their financial affairs before a contract is executed. The information must be provided voluntarily whether requested or not.

### **iv. Sufficiency of Disclosure**

Marriage contracts are usually entered into before any rights between the parties actually exist. Disclosure such as business valuations and real estate appraisals may not be necessary. However, enough detail must be given so that the other

party understands the substance of the contract and the assets that are the subject of the contract.

In marriage contracts where one party wishes to crystallize their date of marriage deductions or to specify particular excluded assets, the more detail that is provided the better.

There are a number of options with respect to providing disclosure:

1. Financial statements on the court form should be exchanged, or statements of net worth which list all assets and liabilities with an indication of how the values are arrived at. Depending on the value and the nature of the asset, valuations and appraisals may be necessary;
2. schedules either for the assets and liabilities or for greater detail, category of assets;
3. a review by an expert.

In all cases there should be sufficient disclosure and back up to reasonably assess the market value and potential growth of an asset.

The greater the discrepancy between the parties' net worth the greater the detail that should be provided.

If there are concerns respecting confidentiality of items such as business documentation a contract may provide that all information given may be kept confidential and that any information reviewed in preparation of the contract must be returned.

### **c. Informed Consent**

The essence of the marriage contract is informed parties consenting to a fair bargain with full disclosure. A party who did not receive full disclosure is considered to have been in a weaker bargaining position and will not have had an opportunity to give truly informed consent if a spouse did not understand the nature and effect of the agreement. “Nature and effect” include the legal consequences of the agreement:

Desromeaux v. Desromeaux (2001) 15 R.F.L. [5<sup>th</sup>] 337 2001 Carswell Ont 1151 (S.C.J.), reversed on other grounds by (2002) 28 R.F.L. (5<sup>th</sup>) 25, 2002 Carswell Ont 2731 (O.C.A.)

The requirement of independent legal advice gives some protection with respect to this issue. However, counsel must take steps to ensure the client has clearly acknowledged their advice. In cases of disparate net worth a clear reporting letter and an acknowledgement are excellent tools. The reporting letter should clearly recite the rights and obligations that the contract intends to govern and

what rights have been waived. The reporting letter should also discuss the disclosure that has been provided and what the consequences are of the agreement. An acknowledgement from the client will assist in protecting the acting lawyer.

No client should be left with the perception that an allegation that he or she failed to understand the contract would be sufficient to invalidate the contract:

### **Unfairness**

Agreements which do not appear to be unfair on their face may not be set aside if they operate unfairly. Unfairness is not an automatic ground to set aside the contract:

Kohani v. Kohani 2002 Carswell BC 787 30 R.F.L. 5<sup>th</sup> 160 (BCCA)

Within the context of parties with disparate net worth all the circumstances of the contract should meet the standard of “utmost good faith and fairness”. It must be clear why one party is prepared to give up potentially substantial claims in future. Marriage contracts usually involve concessions given to the other party for which there should be adequate consideration.

The contract should therefore address this requirement.

Some examples include:

1. creation of a fund where an amount is deposited regularly on behalf of the party releasing their claim;
2. an equivalent release;
3. phased in rights which would occur if the marriage endures and which provide for a termination of the contract after a certain number of years;
4. payment of an old debt or ongoing expense;
5. if a separate excluded class of assets is created the included class of assets will never be less than a proportionate amount of the excluded assets.

Some creativity must be given to the type of consideration and should be fact specific.

The contract should illustrate what concessions or considerations are being given to the party who has the lesser net worth.

### **Common Law Grounds**

Domestic contracts that are invalid according to general contract law are also invalid as domestic contracts under section 56 (4) (c). Common law elements include: uncertainty, duress, practical compulsion, unconscionability, undue influence, misrepresentation, mistake and lack of independent legal advice.

### **a. Duress**

A court may rescind a contract if a party is induced to enter the contract by duress.

Duress involves a threat of wrongful and immediate force in the formation of a contract. There is a distinction between acting under stress as opposed to acting under duress. There is no doubt that the threat of canceling a wedding, ending a relationship or simply being belligerent and difficult is a form of stress. None of these however, may be classed as duress and clients should be prepared to acknowledge that these circumstances do not amount to duress. If a party believes that they are giving up a right to a claim that might be substantial in the future (such as a substantial equalization payment) they need to be advised that stress on its own will probably be insufficient to set aside the contract.

### **b. Unconscionability**

In cases of disparate net worth where the parties have had an existing relationship which has an element of dependency great caution must be exercised. Undue influence and unconscionability are often treated uniformly. For example, see:

Currey v. Currey 2002 Carswell Ont 873 26 R.F.L. 5<sup>th</sup> 34 (S.C.J.)

Wiltmann v. Wiltmann 2002 Carswell Ont 1648

Desromeaux v. Desromeaux (2001) 15 R.F.L. 5<sup>th</sup> 337 (S.C.J.), reversed on other grounds by (2002) 28 R.F.L. (5<sup>th</sup>) 25, 2002 Carswell Ont 2731 (O.C.A.)

A person seeking to set aside a contract because of undue influence must prove that as a result of a pre-existing relationship the other party to the contract had control or power over him or her and used that control or power to extract an unfair bargain:

Foster v. Foster (2000) 5 R.F.L. (5<sup>th</sup>) 315 (Man. Q.B.)

Where a party has taken advantage of an unequal bargaining position a contract may be set aside:

Camilleri v. Camilleri (2000) 13 R.F.L. (5<sup>th</sup>) 18 (S.C.J.) affirmed by 19 R.F.L. (5<sup>th</sup>) 15 (Ont. Div. Ct.)

As stated above, the requirement of disclosure is also relevant to the issue of unfairness. To ensure that a contract is fair to both parties they must be in a position of relatively equal bargaining. A party who was in the position of not receiving sufficient disclosure is considered to have been in a weaker bargaining position and therefore will not have had an opportunity to give truly informed



consent. As parties who have disparate net worth are already perceived to have unequal bargaining positions, meeting the disclosure requirement is crucial.

Unconscionability has a significantly higher threshold than unfairness. Some of the situations involving a higher threshold are:

1. cases where the parties already reside together and one party supports the other;
2. where there is a child of the relationship; and
3. where the parties are already married.

Cases where these circumstances are present require significant concessions to upset a contract even for parties with disparate net worth:

Bucholtz v. Smith 2001 Carswell BC 1915 (BCSC)

Kowalski v. Kowalski 2002 Carswell Alta 1353 (ABQB)

Parties should be advised that it is difficult to establish unconscionability where there is no pre-existing power/dependent relationship:

Scheel v. Henkelman (1999) 3 R.F.L. 5<sup>th</sup> 286, 1999 Carswell Ont 4305 (S.C.J.), reversed on other grounds by 195 D.L.R. (4<sup>th</sup>) 531, 2001 Carswell Ont 28 (Q.C.A)

Trick v. Trick 2003 Carswell Ont 1103 (S.C.J.)

**c. Undue Influence**

While there is a higher standard for parties with disparate net worth, the party with fewer resources should not automatically assume that a contract can be set aside at a later date for undue influence simply because of the inequity in the parties' bargaining positions.

The onus is on the person alleging undue influence to establish that the dynamics of the relationship gave the other party increased power which was inappropriate and created an unfair bargaining position. The power imbalance must exist at the time the contract was entered into:

Koster v. Koster (2002) 33 R.F.L. 5<sup>th</sup> 114, 2002 Carswell Ont 2951 (S.C.J.)

In the Foster case, the court set aside a cohabitation agreement for the parties who had previously separated and then resumed cohabitation.

Factors in the court's decision were:

1. that the wife had taken steps to her detriment in resuming cohabitation;
2. complete lack of financial disclosure;

3. the wife had been abused and intimidated by the husband in the past and did not believe she had any option but to sign the agreement.

A court will not set aside a contract that was freely entered into because of grossly inadequate consideration. There must be evidence that one party took advantage of the other's vulnerability to extract an unfair bargain. However, parties must also be cautioned not to assume that an existing relationship is an automatic escape:

Rosen v. Rosen (1994) 3 R.F.L. 4<sup>th</sup> 267 or 1994 Carswell Ont 390 (C.A.)  
(O.C.A), leave by appeal refused by (1995) 10 R.F.L. (4<sup>th</sup>) 121  
Costa v. Costa (2002) 33 R.F.L. 5<sup>th</sup> 114 (S.C.J.)

In case of parties with disparate net worth the contract will likely meet the test for validity if:

1. sufficient disclosure has been provided;
2. both parties have obtained independent legal advice;
3. parties understood the nature of the bargain; and
4. some consideration has been received.

The party with less net worth should not assume the ground of unconscionability will be open to them because he or she received inadequate consideration:

Kopelow v. Warkentin 2002 Carswell B.C. 2706 (BCSC)

#### **d. Mistake**

The court may set aside the contract if a court is satisfied that a spouse's apparent consent is not true or real because of a mistake in the formation of a contract. This is often a drafting issue. In cases where parties are seeking to exclude particular assets there should be specificity and clarity in the drafting as well as in the description of the assets.

#### **Misrepresentation**

If a party to a contract mistakes a material fact the resulting agreement is voidable at the insistence of the deceived person:

Douziech v. Douziech (2001) 13 R.F.L. 5<sup>th</sup> 389 (Alta.C.A.)

Danylkiw v. Danylkiw 2003 Carswell Ont 457, 37 R.F.L. 5<sup>th</sup> 43 (S.C.J.)

Misrepresentation may take many forms, one of which is the failure to provide appropriate disclosure. Generally, where a party misrepresents his/her assets by leaving an asset out of his/her property statement the court may view this as misrepresentation. However, if both parties are aware of the misrepresentation, it may not be considered "material":

Ruskin v. Chutskoff 2002 Carswell Sask 718 (Sask.Q.B.)

Given the higher standard in marriage contracts and particularly for parties of disparate net worth, any failure to disclose will be given greater weight and is more likely to be fatal to the validity of the contract.

### **Independent Legal Advice and Other Advisors**

The Family Law Act does not contain a provision for independent legal advice and it is not a prerequisite to a valid contract. However, independent legal advice minimizes the risk of invalidity. Courts are not inclined to set aside domestic contracts where a person declined legal advice when he or she had the ability and opportunity to do so. However, in cases of parties with disparate net worth, independent legal advice is crucial for the protection of the wealthier party to the contract as well as for his/her counsel.

Other advisors such as accountants and valuers may also assist to ensure both sufficient disclosure and the essential understanding of the terms of the contract and their impact.

See section 33 (4) of the Family Law Act.

Where one party has a significantly higher net worth, full disclosure is crucial for the following reasons:

1. to ensure the standard of utmost good faith is met;
2. to provide accuracy with respect to deductions and exclusions;
3. to support the perception of a “fair bargain”; and
4. to facilitate the other party’s level of understanding of the true state of affairs and to assess with accuracy what they may be “giving up”.

When these standards are met, the party can have greater security.