PRACTICAL ASPECTS OF ADD BACKS AND COSTS ORDERS

'FLPA IN THE TROPICS' CONFERENCE

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1. ***Introduction***

1.1. The subject upon which I have been asked to speak is practical aspects of add backs and the issue of Costs Orders.

1.2. With respect to property applications no other aspect causes more contention for clients (and ultimately their solicitors) than the issue of costs.

1.3. The seeking of notional moneys to be added back to the pool of assets divisible between parties in property settlement proceedings is a matter which often arises in matters and in which there is often discord between client and solicitor in relation to what should be sought as an add back and what should not.

1.4. Further in regards to the issue of costs, no aspect of Family Law Proceedings is more "real" for clients who are represented by solicitors then the issue of their legal costs, the containment of their legal costs and ultimately issues in relation to whether those costs can be sought from the other side.

1.5. The issues for discussion in this paper therefore are more than just theoretical (although the paper explores the theoretical nature of both costs orders and the issue of add backs and the case law in regards to same).

1.6. It is much more than theoretical because ultimately, in the majority of cases concerning both children's and property orders and in many cases concerning

property orders, clients will seek to contend for both costs order and an add back and it is often difficult to contain clients who wish to make such arguments.

1.7. This paper therefore whilst dealing with the statutory framework and case law in regards to both costs and add backs gives solicitors some practical pointers for dealing with the matters with both the Court and their clients.

2. ***Costs Orders***

2.1. Invariably, and we have all seen it in the multitude of cases that each of us have run before both the Federal Circuit Court and Family Court, an Order in terms like "That the Respondent Father pay the Applicant Mother's costs of and incidental to these proceedings" is common in the Applications and Responses that are filed in the Court.

2.2. Why this is the case, and I simply proffer an opinion here, is that the party seeks the other side pay their costs because in their view they may be of the belief that they have done everything possible to try to settle the matter without having to engage a lawyer post their relationship breakdown and the other side has been 'difficult' and 'not accommodating' in that regard.

2.3. In short therefore, the client may feel that he or she is getting a "raw deal" by having to attend upon a lawyer and pay to them moneys for their services and such they wish those moneys to be reimbursed.

2.4. Solicitors and counsel are therefore often grappling with issues concerning their client whereby their client wishes to have moneys reimbursed to them whilst knowing or ought to know that their client doesn't have good prospects or very limited chances of having costs orders made in their favour.

2.5. It is therefore necessary, firstly, and before discussing the relevant legislation and case law in relation to Costs, to consider managing the client's expectations at the initial stage.

2.6. Clients must be advised at the stage where such an Application is made that a costs order may not be made in their favour and the circumstances in which a Court may award them a costs order.

2.7. In particular, and with reference to this, it may be prudent to discuss with the client the making of an offer to the other side, the timing of such an offer (particularly in relation to a property proceedings), the risks associated to them in not considering offers from the other side, and what they will need to show to the court ultimately at an interim hearing or Trial in order for a costs order to be granted in their favour.

2.8. The relevant section of the *Family Law Act 1975* "the Act" dealing with the issue of costs orders is section 117 of the Act.

2.9. Pursuant to section 117(1) of the Act, each party to a proceeding bears his or her own costs unless the court is of the opinion, pursuant to section 117(2) of the Act, that a costs order is warranted.

2.10. Paragraph 117(2A) of the Act sets out a number of indicia that that court must consider in making any order as to costs. Section 117(2A) of the Act says the following:

"In considering what order (if any) should be made under subsection(2), the court shall have regard to:

(a) the financial circumstances of each of the parties to the proceeding;

(b) whether any party to the proceedings is in receipt of assistance by way of legal aid and, if so, the terms of the grant of that assistance to that party;

(c) the conduct of the parties to the proceedings in relation to the proceedings including, without limiting the generality of the foregoing, the conduct of the parties in relation to pleadings, particulars, discovery, inspection, directions to answer questions, admissions of facts, production of documents and similar matters;

(d) whether the proceedings were necessitated by the failure of a party to the proceedings to comply with previous orders of the court;

(e) whether any party to the proceedings has been wholly unsuccessful in the proceedings;

(f) whether either party to the proceedings has made an offer in writing to the other party to the proceedings to settle the proceedings and the terms of any such offer; and

(g) such other matters as the court considers relevant."

2.11. It is practical, and common sense, that any case in which costs are sought deal with the indicia as is set out in section 117(2A) of the Act, namely, that Affidavit material in respect to a costs application deal with each of the sections of the Act.

2.12. I am not suggesting that this necessarily be done at the interim stage because any offers to settle between the parties will be privileged until such time as the issue of costs becomes a live issue before the court and any offers are provided by way of tender or affidavit to the presiding judicial officer.

2.13. The presence of one of the factors in section 117(2A) however, and not others, does not preclude the court from making an order as to costs.

2.14. Murphy J in the decision of *Donaghey v Donaghey* (Cost) (2012) 47 Fam LR 306 at paragraphs 31 and 32 of that case said the following in regards to the inter-relation between the factors in section 117(2A) as follows:

"31 - It is plain that section 117(2A) does not prescribe that more than one factor must be present or that any one factor has more or less weight than any other"

32 - Of particular relevance here is the fact that modest, or even poor financial circumstances, is not determinative of the issues. Were it otherwise, the discretion inherent in this section would be curtailed and one of the enumerated factors will preclude appropriate consideration being given to all factors relevant to the discretion."

2.15. That is to say that just because one party is in a poor financial position, then a court should not simply consider not making an order as to costs.

2.16. The financial circumstances of each of the parties and their ability to satisfy a costs order however will be a relevant issue not only for the court but for the successful litigant to any application.

2.17. Namely, an example where a litigant receives an order as to costs but there is no likelihood that the costs order will be paid or alternatively that it will be very difficult to enforce the terms of the costs order against the non-successful litigant.

2.18. A Financial Statement will be relevant in this regard. Often, for example in children's matters, it may be prudent to adjourn any costs application to be made on written submissions after a time when each of the parties have filed a financial statement and, if necessary, given discovery in regards to the financial circumstances.

2.19. In a costs application where a financial statement has already been filed, it is important in submissions to look, in my opinion, at the depositions made by the person against whom the order for costs is being sought. So in essence here, what I am saying is try and use the other sides material to advance your client's case.

2.20. The attack there and the submission that needs to be made in regards to that point is where the funds will come from to satisfy any orders as to costs.

2.21. This is not only for the purposes of the court but for the purposes of the litigant seeking a costs order because, as I have said above, whilst a party may be successful on a costs order, payment is another matter.

2.22. Therefore, when looking to a Financial Statement for the purposes of making submissions concerning a costs application, solicitors and counsel should look to the issue of income versus expenditure and also in respect to the assets of each of the parties.

2.23. In particular in respect to the first point, if for example the Respondent to a costs order application has an excess income over expenditure of for example $300.00 per week, the sensible submission to make to further the application for costs is that, once the issue of quantum of costs has been quantified by the court, the court make an order that the respondent pay the costs order in the amount of $300.00 per week until such time as the order has been satisfied.

2.24. Such a submission, in my opinion, gives the court the ability to make a finding, on the other side's documents, as to a capacity to pay and therefore, rather than deposing to the litigant's own evidence concerning the other side's capacity, you are using the other side's own sworn document to support your case.

2.25. In regards to the issue of ability to pay where there is no excess income over expenditure, another way to approach the issue of submissions on costs is to focus an attack on the assets of the party in the financial statement. As to the ability for that asset to be sold or otherwise disbursed to pay a costs order.

3. ***What type of Costs Order to seek***

3.1. If you are seeking a costs order in a proceeding the first issue for the court that will arise is "should the client be seeking indemnity costs or scale costs."

3.2. My view is to argue the point both ways, I explain my reasoning in that regard as follows.

3.3. Indemnity costs are most conveniently defined as the actual costs that have been incurred between client and solicitor in the conduct of the proceedings.

3.4. The test in respect to indemnity costs is a high test.

3.5. In short indemnity costs orders are made in circumstances where there is a making of relevant allegations of fraud, evidence of misconduct which has caused loss of time, proceedings commenced for ulterior motives, a willful disregard for known facts or law, the making of allegations which ought never have been made or an imprudent offer to compromise.

3.6. The case most cited in regards to the issue of indemnity costs is *Colgate Palmolive Co. v. Cussons Pty Ltd* (1993) 46 FCR 25; 118 ALR 248; 28 RPR 561 where Sheppeard J at paragraph 24 set out the principles and guidelines which he distilled from the authorities in regards to indemnity costs orders.

3.7. His Honour said at paragraph 24 the following in relation to the discretion to be applied in each case as follows:

> *'Other categories of cases are to be found in the reports. Yet others to arise in the future will have different features about them which may justify an order for costs on the indemnity basis. The question must always be whether the particular facts and circumstances of the case in question warrant the making of an order for payment of costs other than on a party and party basis'*

3.8. It remains to say that the existence of particular facts and circumstances capable of warranting the making of an order for payment of costs, for instance, on the indemnity basis, does not mean that judges are necessarily obliged to exercise discretion and make such an order.

3.9. Costs orders are always in the discretion of the Judge. Provided that discretion is exercised having regard to the applicable principles, the particular circumstances will not be found to have miscarried unless it appears that the order which has been made involves a manifest error or injustice.

3.10. The categories of cases giving rise to an indemnity costs order are not closed however in the case *of Yunghanns v Yunghanns* (2000) 26 Fam LR 331 the court said at paragraph 31:

> *'All that is required is that the court asked to exercise a discretion must be satisfied that some particular facts and circumstances of the case in question warrant the making of an order for the payment of costs other than on a party and party basis'*

3.11. It must be remembered in advising clients that costs are not awarded as a punishment one party to the other (*Latoudis v Casey*) 1990 170 CLR 534 at 543.

3.12. Equally however conduct that might otherwise give rise to a punishment can be directly relevant to a consideration of indemnity costs.

3.13. In preparing an application for indemnity costs or an application under the Family Law Rule Scale, it will be necessary in the event that the litigant seeks that the court set the amount of costs, other than an order to say that "the costs be taxed or agreed", to provide affidavit material setting out how the costs have been incurred so the court can consider whether such costs are reasonable.

3.14. In my view the most simplistic and persuasive way to do that is for the solicitor who incurred the cost to depose to an affidavit setting out what the costs incurred have been.

3.15. As a solicitor this is a practice I adopted in support of any application made for costs on an indemnity basis.

3.16. The manner in which the affidavit should be set out is, in brief, as follows:

3.16.1. identify whether you are the principal of the firm acting on behalf of the client or the solicitor with the conduct of the matter;

3.16.2. set out the date of engagement of the client with your firm;

3.16.3. set out that the costs are calculated in accordance with a specific hourly rate (or other such manner in which costs are calculated and set out the manner in which the costs are calculated i.e. on a page basis or on an hourly rate);

3.16.4. set out that the costs are calculated in accordance with costs agreement such agreement which can be made available to the court and to the other side (if necessary);

3.16.5. set out in tabular form the date, person incurring the cost and the amount incurred, next total up those amounts, next include a section in the affidavit as to any disbursements (such as Counsel's fees and annex a copy of the relevant fee notes in that regard).

3.17. I touched before on arguing an order for costs 'both ways'.

3.18. Ultimately you may not be successful in your application for indemnity costs. You may however be successful in an application for costs to be awarded on a scale basis because the Court determines that your client is deserving of an order for costs, but you don't meet the high test I have referred to above.

3.19. In those circumstances, go armed to Court with what those scale costs are. The scales are easily found at Schedule 3 of the *Family Law Rules* in relation to Family Court costs and at Schedule 1 of the *Federal Circuit Court Rules* in relation to Federal Circuit Court costs.

3.20. This will allow you to give to the Judge hearing your matter the amounts and how you arrive at them with reference to the Scale with a rider such as 'if Your Honour is against me on indemnity costs, my client seeks scale costs in the amount of x calculated as follows …'.

3.21. Remember, in relation to an argument as to costs, as in any argument before a Court your role in advancing your client's case is to assist the Judge as much as you can to make a decision and the best way to do that is to be as prepared as you possible can be.

4. ***Add Backs***

4.1. Invariably one of the most difficult issues for determination by the court in property proceedings, and also in managing client's expectation, is the issue of seeking a add back be found in the pool of assets available for distribution between the parties.

4.2. Usually the court deals with property which is in existence and able to be quantified.

4.3. There are times though, when the court is not dealing with such property usually described as "notional property" but sometimes described as "financial resource" examples which include:

(a) money already spent (eg on legal costs);

(b) property disposed of or used for the benefit of one party;

(c) property not disclosed or accounted for.

4.4. A good summary of what is considered to be notional property was given by Nicholson CJ in the case of *Townsend & Townsend* (1995) FLC 92 – 569 where His Honour said at p 81,654:

"*In my view, what occurred in this case, as I said during the course of argument was, in fact, a premature distribution of a proportion of the matrimonial asset. What the husband did was to distribute to himself an asset which the wife had a legitimate interest. In such circumstances I consider that would be unjust in the extreme simply treat such conduct by the husband as a matter to which regard should be had under section 75(2) seems to me that the husband has had the benefit of that money. Had he retained, for example the taxi license instead of selling it, that would have been brought into account as an item of property which would have been dealt with in the same way as the remaining items of property in this case. Accordingly I am of the view that the correct way in which to deal with the husband's receipt of those moneys is to bring them into the pool of assets on a notional basis and make a distribution accordingly."*

4.5. The court has, in recent times "tightened" the requirements in respect to arguing the issue of a notional add back.

4.6. The Full Court of the Family Court in the case of *Mayne v Mayne* (2011) 46 Fam LR 197 at paragraphs 82 – 84 said the following in relation to the issue of notional add backs:

"*82 - By definition it would seem that property which has been spent when the matter is before the court is no longer there and is not property;*

83 - In summary comment in most respects notional property pools and 'add back' should be applied sparingly. The court is 'not to make an order… unless it is satisfied… it is just and equitable to make the order'

84 - It may be that the proper place for consideration of adjustments to property division in the nature of 'add backs' in the fourth step of the court's consideration. If one party is unjustly appropriated funds or assets to himself or herself it will be inequitable to disregard that fact."

4.7. One of the "add backs" that is usually argued in cases is the treatment and add back of moneys expended on their lawyers for legal fees.

4.8. The leading authority in regards to this point is that of *Chorn & Hopkins* (2004) FLC 93-204 where the Full Court held that the principles that might guide the exercise of discretion in regards to the treatment of add backs for legal fees are as follows:

"*57 - The funds used existed at separation, and as such both parties can be seen as having an interest in them (on account, for example, of contributions) and such funds should be added back as a notional asset of the party who has had the benefit of them.*

58 - If funds used to pay legal fees have been generated by a party post separation from his or her endeavors, or received in his or her own right (for example by gift or inheritance) they would generally not be added back as a notional asset. Funds generated from assets or businesses to which the other party has made a significant contribution, or as an actual legal entitlement may need to be looked at differently from other post separation income or acquisitions.

59 - Outstanding legal fees themselves are not generally taken into account as a liability.

60 - If, in the exercise of discretion, it is determined that legal fees already paid should be taken into account as a notional asset, then normally any liability

associated with the acquisition of the moneys used to pay the legal fees should also be taken into account."

4.9. The Full Court in *Omacini & Omacini* (2005) FLC 93 – 218 noted the circumstances in which it is appropriate to notionally add back to the pool of assets. These fall into "three clear categories":

(1) where the parties have expended moneys on legal fees;

(2) where there has been a premature distribution of matrimonial assets; and

(3) in the circumstances outlined in Kowaliw.

4.10. In that case the court said that the financial losses incurred by the parties or either of them during the course of a marriage should generally be shared by them, although not necessarily equally.

4.11. His Honour Murphy J in *Kouper v Kouper* (No. 3) [2009] FAMCA 1080 considered further the issue of notional add backs.

4.12. His Honour said at paragraph 92 of his judgment the following:

"*Adding back to the pool is the exception, not the rule. An exception can exist where one party has embarked upon a course of conduct designed to reduce or minimize the effect of value or worth of matrimonial assets; or where one of the parties has acted recklessly, negligently or wantonly with matrimonial assets, the effect of which is reduced or minimized their value of the pool of assets"*

4.13. In the same judgment His Honour gave to us a clear path for consideration of whether an add back should be contended for or not, and in particular set out five indicia at paragraph 108 of his judgment. His Honour said at that paragraph the following:

"Whilst, clearly enough, the authorities make it plain that the manner in which any dissipation of funds should be dealt with is a matter for the trial judge

discretion in accepting the discretion or not, of course, be fettered, it nevertheless seems to me that (leaving aside the issue of paid legal fees, the authorities indicate that the issue can, conveniently, be approached by reference to five questions

(a) is it contended that property (including money), that would otherwise be available for distribution between the parties if a section 79 Order is made, has been dissipated with a consequential loss to the property otherwise potentially divisible between the parties at the date of trial?;

(b) if so, is it alleged that the dissipation of property was in respect of things other than what, in particular circumstances of this particular marriage, can be classified as "reasonable living expenses";

(c) if it is asserted that any loss to the divisible property results from dissipation of property other than in respect of such expenses, why is it asserted that the result should be a sharing of that loss by the parties other than equally?

(d) if it is contended that this be the result, why should there be an add back (which brings to account, dollar for dollar, such past expenditure in current dollars) as distinct, for example, from there being an adjustment made pursuant to section 75(2)(o)?;

(e) how should either an add back or adjustment pursuant to 75(2)(o) be quantified."

4.14. The case of Stanford is a topic on which there will be discussion this afternoon and Murphy J has further considered the issue of add backs in light of that decision.

4.15. In *Watson & Ling* [2013] FAMCA57 His Honour said the following in relation to add backs in light of the Stanford case:

> *'30 – The notion that such money or property should be treated as a 'notional asset' or 'notional property' appears to run contrary to the thrust of the decision in Stanford: at issue is the consideration of two separate questions, the first of which is whether existing legal or equitable interests should be altered'.*

4.16. It is clear from that case that the issue of add backs is going to be open to further discussion in the cases that follow Stanford.

4.17. Using His Honour's comments in *Kouper* is a convenient way for solicitors to both structure their affidavit material in relation to the issue of add backs and further to argue the matter before a Judge in relation to the issue.

4.18. Sometimes it may be abundantly clear that moneys used by one party is an add back.

4.19. If for example, the parties have a joint account (or one party has an account at the time of separation) and moneys are used by the party for the payment of their legal fees, clearly discernible on the discoverable material, it is likely that, with reference to the case authorities above, the court is going to find that the moneys should be notionally added back to the pool because, in essence, the test is as the authorities discuss, what were the funds at time of separation which would otherwise have been in the pool but for the dissipation.

4.20. What has become more "muddy" however when it is contended for example as it is in many cases that moneys have been expended by one party which are either "unaccounted for" or "excessive to reasonable living expenses" and the courts job then becomes one of determining what the quantification of the amount should be

and the court is then charged with the responsibility of making findings in respect to how the money was expended.

4.21. In such circumstances, an Affidavit which sets out clearly what the amount is and how it is arrived is imperative.

4.22. An affidavit which simply annexes a number of schedules will be of no use to the court unless the contention is backed up with the supporting documents or alternatively the supporting documents are put to the witness through the course of cross examination.

5. ***Conclusion***

5.1. The issues concerning both costs orders and notional add backs are difficult ones for both solicitors and their clients.

5.2. This paper has provided the case law, legislative framework, and practical issues concerning the two issues of costs and add backs.

5.3. Finally, early advices in respect to both issues and managing client expectations as to the issues and arguing those cases in which there are good prospects on either issue will make for a better outcome and a more satisfied client in the long run.