

# The FOS Approach to Terms of settlement

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We have created a series of FOS Approach documents, such as this one, to help consumers and financial services providers better understand how we reach decisions about key issues.

These documents explain the way we approach some common issues and dispute types that we see at FOS. However, it is important to understand that each dispute that comes to us is unique, so this information is a guide only. No determination (decision) can be seen as a precedent for future cases, and no FOS Approach document can cover everything you might want to know about key issues.

## 1 At a glance

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### 1.1 Scope

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FOS seeks to resolve disputes between an applicant and a financial services provider (FSP) in a cooperative, efficient, timely and fair way. Disputes resolved by mutual agreement are usually recorded in writing as terms of settlement.

This document sets out our approach to settling disputes or interpreting terms of settlement documents, by outlining:

- what to consider with non-standard terms of settlement documents
- what governing principles should inform the terms of settlement
- how the terms of settlement should show the dispute is resolved
- how previous terms of settlement can affect a further or current dispute with FOS.

This approach will help:

- the applicant before signing the terms of settlement
- the FSP when drafting any terms of settlement.

### 1.2 Summary

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It is important when finalising a dispute at FOS that the terms of settlement are a clear and accurate record of the agreement between the applicant and the FSP. Otherwise, the resolved dispute could be jeopardised by later, further disputes about the content of those terms.

FOS expects terms of settlement to:

- be drafted fairly with a clear scope, usually in line with one of our standard templates
- follow our core guiding principles to protect each party's rights
- clearly set out the consequences of defaulting on the agreement
- cover the FSP's right to enter judgment on default or to restore legal proceedings, if the applicant breaches the terms.

In some disputes, we will also consider:

- previous terms of settlement that the FSP and applicant have agreed
- liability in third party settlements, particularly in family law cases.

## 2 In detail

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### 2.1 Drafting terms of settlement

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#### Who supplies the terms of settlement?

If the FSP asks the applicant to agree to terms of settlement following a Recommendation or Determination, it will have to prepare the document and cover the costs for this. The applicant should get legal advice on any non-standard terms of settlement. We may ask the FSP to pay the applicant's costs for this.

However, FOS may record the terms of any settlement reached in a FOS telephone conciliation conference and provide it to the parties.

#### Does FOS check the FSP's terms of settlement?

We do not give the applicant legal advice on the effect of the FSP's terms of settlement. However, we will do a limited review and if we find the document unacceptable, we will ask the FSP to redraft it.

We may find the terms of settlement unacceptable where:

- the scope is unreasonably wide, especially where the FSP seeks to be released from being liable for its conduct beyond the dispute or settlement negotiations
- it does not reflect the Recommendation, Determination or dispute resolution agreement
- it does not follow FOS's governing principles.

### 2.2 Understanding our governing principles

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#### What should the terms of settlement cover?

The following governing principles should inform the terms of settlement to help prevent a future dispute from derailing the resolution agreed at FOS:

1. The terms of settlement should finalise the dispute.
2. They should reflect the agreement between the FSP and the applicant, and not introduce new terms.
3. They should expressly deal with the consequences of not complying with them. But this should not allow the FSP to try to recover more than the agreed settlement amount plus recovery costs (except where the debt has not been disputed, or the applicant is free to defend the initial claim).
4. An FSP should use plain English when drafting its own terms of settlement.

#### How should the terms of settlement deal with defaults?

The terms of settlement should follow these principles for defaults and legal proceedings:

1. The terms of settlement should generally give the applicant 7 days notice to remedy a default before the FSP takes action. If the FSP then intends to reinstate legal proceedings, the notice should state that the FSP may obtain judgment by default unless the applicant corrects the default or files a defence with the court.
2. They should not prevent the applicant from disputing whether either party complied with the terms of settlement.
3. They may allow discontinued legal proceedings to be restored or reinstated on default. If so, the proceedings might need amending to reflect that a settlement agreement was not met.
4. They should not require the applicant to consent to judgment.

## **2.3 Understanding the effect of a settlement agreement**

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### **How is the settlement documented?**

FOS expects that when the applicant and the FSP agree to resolve a dispute, it means the dispute will end. Documenting the terms of settlement is not a chance for either party to then change a mutually agreed resolution.

What regularly derails an agreement is when the terms of settlement do not include the consequences of either party not complying. It is important to include this in any agreement to resolve the dispute.

Generally, the terms of settlement:

- are binding
- effectively replace all previous contracts and arrangements to do with the dispute.

The usual remedy if a settlement agreement is breached is to sue the party for breaching it. See *McDermott v Black* (1940) 63 CLR 161, *Osborn and Bernotti v McDermott* [1998] 3 VR 1 and *Masters v Cameron* (1954) 91 CLR 353.

### **What if the applicant disputes the debt?**

Often, an applicant who disputes liability will agree to give up the dispute in exchange for paying the FSP a smaller sum, rather than the sum owed under the disputed contract.

Where this occurs and the applicant does not make the required payments, the FSP can only take legal action to recover the smaller sum agreed in the settlement plus recovery costs. If the FSP recovers more than the agreed settlement sum and costs, it can contravene the doctrine of penalties.

The FSP would be in breach, for instance, if it recovers the amount the applicant first owed under the original contract. This is because:

- the original, larger sum owing was not an accepted debt
- the applicant gave up rights in exchange for the FSP agreeing to a smaller sum being paid.

For more on this, see *Zenith Engineering Pty Ltd v Queensland Crane & Machinery Pty Ltd* [2000] QCA 221 and *Duffy Bros Fruit Market (Campbelltown) Pty Ltd v Gumland Property Holdings Pty Ltd* [2007] NSWCA 7.

### **What if the applicant does not dispute the debt?**

By contrast, if the applicant does not dispute the debt, but instead seeks a revised payment plan, this is sometimes called an 'indulgence'. It often arises if the applicant faces financial difficulty in paying the owed sum.

In such cases, the applicant:

- accepts the amount the FSP says is the owed debt
- has not given up any defences in exchange for paying a smaller sum.

In these disputes the terms of settlement can allow the applicant to pay the full debt (not just the smaller sum) if they default on the agreed settlement payments. If the settlement agreement does not specify a sum to be paid on default, the applicant must generally pay the full undisputed debt.

### **Can the parties agree that terms of settlement can be cancelled?**

The FSP and the applicant can agree that the terms of settlement will not stay in place unless the applicant meets their obligations. This usually depends on the applicant making payments in line with the settlement terms.

If the applicant defaults on the payments, the settlement agreement remains incomplete and becomes ineffective. The FSP and applicant then return to their original positions before they agreed to settle the dispute. The FSP can seek to enforce its original rights and the applicant can again mount their initial defence.

## **2.4 Going to a judgment on default or restoring legal proceedings**

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### **How can the FSP pursue court action if the applicant defaults?**

If the applicant does not make the agreed payments in line with the terms of settlement, the FSP can ask for a court judgment for a breach of the settlement agreement.

But the terms of settlement should not require the applicant to agree to judgment. A settlement agreement must allow the applicant to dispute that judgment if they claim that they did comply with it and did not breach the terms of settlement.

The FSP should generally give the applicant at least 7 days notice of a default on the terms of settlement.

### **Can the FSP restart legal proceedings after settlement?**

Sometimes, a dispute is subject to legal proceedings that have been issued but not yet determined. Under our Terms of Reference, the FSP must not pursue those proceedings while we consider that dispute.

Where proceedings have been discontinued and the dispute settled, but the applicant has then not complied with the terms of settlement, the FSP can seek to restore or reinstate those proceedings.

However, the terms of settlement must include the FSP's right to do this. We consider this acceptable because it saves in court costs that the applicant would ultimately need to pay if the proceedings have to be reissued.

But in such cases, the FSP must give the applicant at least 7 days notice of the default to give them the chance to raise any defence to that default.

## **2.5 Interpreting previous terms of settlement**

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### **How can a previous settlement affect a new dispute?**

In some disputes, FOS must review the previous terms of settlement agreed to by the applicant and the FSP to determine whether a new dispute lodged with us has been previously dealt with.

This could be where the applicant has given the FSP a release relating to a previous dispute in broad terms. For example, 'I release the FSP from any claims and all liability to do with home loan XYZ'. The question we must address is whether releasing the FSP from 'all liability' stops the applicant from bringing a further dispute.

## Which principles of interpretation apply?

Principles for interpreting terms of settlement are summarised by J Santow in *Karam v ANZ Banking Group* [2001] NSWSC 709 at [406]. They are that:

1. The terms of settlement are to be interpreted as conveying the meaning that a reasonable person with the same background knowledge as both parties reasonably had when they signed it.
2. General words in the terms of settlement are limited to what the parties specifically considered the words to mean when they reached their agreement.
3. Generally, the parties did not intend to surrender rights and claims they were not aware of having when agreeing to the settlement.

This is why we interpret general words in terms of settlement that release the FSP from all liability as a release only from liability for issues relating to the settled dispute. A general release does not apply to a further claim on a different matter.

## 2.6 Making third party settlements

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### How are the applicant's rights affected in a third party settlement?

An issue can occur where a third party is part of the dispute. For example, a mortgage broker may have misled the applicant about a loan interest rate. If the broker was the FSP's agent, the applicant has a potential claim against the FSP, for the conduct of the broker, and the broker.

A third-party settlement agreement will often be in broad terms, such as the applicant agreeing not to bring any claim in any forum for that dispute.

If the applicant settles the dispute against the broker, it could affect their ability to also bring a dispute against the FSP. We will interpret a settlement as only settling the applicant's claims against the other party to the agreement – in this case, the broker. The applicant can make a further claim, but cannot be compensated for more than their full loss. If the applicant is fully compensated under a settlement with a third party, they cannot continue a dispute against the FSP as there is no outstanding loss.

### What happens in family law settlements?

This issue often arises with family law settlements. Commonly, partners in a relationship hold a joint account. If both need to agree to a withdrawal and the FSP mistakenly allows one account holder to withdraw funds in breach of the account authority, the applicant can claim against both their partner and the FSP.

If there are then legal proceedings over the partners' asset and liability allocations, it is often difficult to determine from the related settlement if the applicant was compensated for the loss caused by the FSP's breach of mandate.

In such cases, FOS will not be able to determine the dispute, as we cannot calculate the loss. We only consider disputes where:

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- the other party received notice in writing that the applicant intended to separately make a future claim against the FSP for the loss, or
- the applicant expressly reserved the right to make a future claim against the FSP in the property settlement, or
- the applicant was not, and could not have been, aware of the error at the time of the settlement, or
- we can determine from the terms of the settlement that the applicant was not fully compensated, but we will not go beyond the settlement document to do so (please see case study 1).

## 3 Context

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### 3.1 Case studies

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#### Case 1: Unclear third party settlement payment prevents a claim

The applicant had a joint account with her husband and either could make withdrawals. Their relationship assets were:

- the home, valued at \$500,000 (each had a 50% share)
- \$100,000 in the joint account.

Before her husband died:

- he changed his will, leaving all his assets, including his share of the house, to her step-daughter rather than to her, as had been the case
- she transferred \$50,000 from their joint account into an account in her name only
- he then transferred that \$50,000 into an account in his name only.

After her husband died, the applicant made two claims against both his estate and her stepdaughter:

- that his new will had been made under duress and was not valid
- for the return of the \$50,000 he had transferred from her account.

She settled this claim in exchange for a lump sum of \$100,000. But the settlement did not apportion that payment between her two claims.

She then lodged a claim with us against the FSP for the \$50,000 it had allowed her husband to withdraw from her account without authority.

We took the view that:

- the FSP had breached its obligations to the applicant by allowing the unauthorised withdrawal
- settling the claim with the estate and her step-daughter did not prevent a further claim against the FSP because it was not a party to that settlement.

However, we could not determine if the applicant had been fully compensated for \$50,000 taken from her account because her lump sum payment had not been apportioned. We could not consider the dispute.

We could have done so, for instance, if the previous terms of settlement had specified that in the settlement sum:

- \$80,000 was for her claim the will was invalid
- \$20,000 was for her claim about wrongful access to her account.

She then could have made a claim against the FSP for the remaining \$30,000 for wrongful account access.

**Case 2: Broad settlement terms allowed a further claim**

The applicant had a home loan with the FSP and fell into default after losing his job. After unsuccessfully negotiating with the FSP to vary the loan repayments due to financial difficulty, the applicant lodged a claim with us.

The dispute was settled with an agreement the applicant could make lower monthly repayments for three years. The terms of settlement were broadly in satisfaction of 'all claims' against the FSP.

One year later, the applicant lodged a further claim against the FSP about being misled over the home loan interest rate. The FSP argued we could not consider the dispute as the applicant had previously settled 'all claims' against it.

We took the view that despite this broad expression in the previous terms of settlement, it applied only to applicant's initial dispute with the FSP over the lowering of the loan repayments.

We accepted that the applicant could make the further claim against the FSP.

## 3.2 References

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### Definitions

Term	Definition
applicant	individual or small business that has lodged a dispute with FOS
borrower	individual or small business who has taken out a loan from an FSP
FSP	financial services provider, a business that has chosen FOS as its external dispute resolution scheme and provides a financial service

### Useful links

Document type	Title / Link
<a href="#">Terms of Reference</a>	The Financial Ombudsman Service Terms Of Reference can be accessed at <a href="http://www.fos.org.au/tor">www.fos.org.au/tor</a> .
Case law	McDermott v Black (1940) 63 CLR 161.
Case law	Osborn and Bernotti v McDermott [1998] 3 VR 1.
Case law	Masters v Cameron (1954) 91 CLR 353.
Case law	Zenith Engineering Pty Ltd v Queensland Crane & Machinery Pty Ltd [2000] QCA 221.
Case law	Duffy Bros. Fruit Market (Campbelltown) Pty Ltd v Gumland Property Holdings Pty Ltd [2007] NSWCA 7.
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