

Part K -
Should the
PRA affect
the rights of
creditors?

Chapter 31 – The PRA and creditors

Introduction

- 31.1 The focus of this part is how the PRA deals with the rights of creditors. Partners in a relationship will usually carry debt, either individually or jointly. For example, one partner might have purchased a television on hire purchase or the partners might buy a car through a finance arrangement which is paid off in instalments. A mortgage over the family home is a common example of the debt partners might still have at the end of the relationship.
- 31.2 The general position taken by the PRA is that the rights of creditors are not affected by the PRA. There are, however, some limited exceptions to this general rule.
- 31.3 In this part, we address:
- (a) The general rule that the rights of creditors are not affected by the PRA;
 - (b) the exceptions to that rule; and
 - (c) issues with the way the PRA treats creditors' rights and possible options for reform.

The rights of creditors under the PRA

The general rule – the rights of creditors are not affected by the PRA

- 31.4 Two key sections in the PRA govern the relationship between partners' relationship property entitlements and the rights of creditors.

- 31.5 The first provision is section 19, which is fundamental to the overall scheme of the PRA. It states that, unless the PRA expressly provides to the contrary, nothing in the PRA:
- (a) affects the title of any third person to any property, or the power of either partner to acquire, deal with, or dispose of any property, or enter any legal transaction as if the PRA had not been passed; or
 - (b) limits or affects the operation of any mortgage, charge, or other security for the repayment of a debt given by either partner over the property he or she owns.
- 31.6 Section 19 preserves each of the partner's rights to deal with their property as if the PRA had not been passed, including incurring debts and using their property as security. As section 19 clarifies, this general rule is subject to the other provisions of the PRA. The principal limitations of this general rule are the PRA's rules of division when the relationship ends. The PRA is often called a "deferred" regime, because its rules of property division only apply after the partners have separated. Until that point in time, section 19 preserves the partners' rights to deal with their property. Conversely, section 19 protects the rights of the creditors with whom the partners deal.
- 31.7 The second provision is section 20A. Section 20A is in very similar terms to section 19. It provides that the secured and unsecured creditors of a partner have the same rights against that partner as if the PRA had not been passed.¹ Like section 19, section 20A is subject to the other provisions of the PRA.
- 31.8 The general effect of section 19 and section 20A is to provide that creditors suffer no prejudice to their rights unless the PRA expressly provides to the contrary.

¹ Likewise, if, had the Property (Relationships) Act 1976 (PRA) not been passed, any property would have passed to the Official Assignee on or following the bankruptcy of a spouse or partner, then that property (and no other property) passes to the Official Assignee as if the PRA had not been passed: s 20A(2). Section 46 also provides for the specific case of secured creditors when the court makes orders under the PRA. Section 46 provides that that the rights conferred on a partner under the PRA will be subject to the rights of a person entitled to the benefit of any mortgage, security, charge, or encumbrance affecting the property in respect of which the order is made, provided it was registered before the order was registered or the rights arise under an instrument executed before the making of the court order.

Exceptions to the general rule

31.9 There are only limited instances where the PRA affects the rights of creditors. We set out the main provisions below, although there are other lesser ways in which creditors' rights might be affected.²

Protected interest in the family home – section 20B

31.10 Section 20B(1) provides that every partner has a protected interest in the family home.³ Section 20B(2) provides that the protected interest of a partner is not liable for the unsecured debts of the other partner.⁴ In other words, if the creditors of one partner claim the entirety of the family home in satisfaction of that partner's debts, the other partner's interest will take priority to the extent of the protected interest.

31.11 The value of the protected interest is the lesser of either half the equity in the family home⁵ or the "specified sum" as set by regulations under section 53A. The specified sum is currently set at \$103,000.⁶

31.12 The rationale behind section 20B is clear. The drafters of the PRA saw the family home as the principal family asset that would constitute relationship property under the equal sharing regime.⁷ It therefore deserved particular attention.⁸ In a White Paper accompanying the Matrimonial Property Bill 1975 the Minister of Justice explained that the basic philosophy of the protected interest provision was that matrimonial property should not be

² The case *Monocrane NZ Ltd (in liq) v Moncur* [2016] NZCA 139, [2016] NZFLR 455 provides an unusual example. When a husband and wife separated they entered a settlement agreement to settle their property affairs. The agreement included terms in which a company through which the husband conducted business in effect gave up rights against the wife but instead received the benefits of financing secured over the wife's home. In these circumstances, the Court of Appeal held that the company should be estopped from denying it was bound by the agreement and had improperly lost its rights. The Court observed that the agreement conferred considerable benefits on the company and therefore its rights should be properly confined by the agreement made under the Property (Relationships) Act 1976.

³ If no family home exists because it has been sold, or because none existed, or because the family home exists as a homestead, the protected interest applies to the proceeds of sale, or the property or money shared in place of the family home, as the case may be: Property (Relationships) Act 1976, ss 11A–12.

⁴ Unless the debt has been incurred by the partners jointly or the debt has been incurred by a partner subsequently declared bankrupt for the purpose of acquiring, improving, or repairing the family home: Property (Relationships) Act 1976, s 20B(2).

⁵ If the home has been sold, the relevant value will be the sale proceeds: Property (Relationships) Act 1976, s 11A. If the partners had no family home, the relevant value will be in the money shared in the absence of a home: ss 11B and 12.

⁶ Property (Relationships) Specified Sum Order 2002, cl 3.

⁷ AM Finlay "Matrimonial Property – Comparable Sharing: An Explanation of the Matrimonial Property Bill 1975" [1975] II AJHR E6 at 8.

⁸ AM Finlay "Matrimonial Property – Comparable Sharing: An Explanation of the Matrimonial Property Bill 1975" [1975] II AJHR E6 at 8.

seized to satisfy the purely personal creditors of the other spouse. Otherwise, the Minister reasoned, “a husband, for example, by mounting up excessive debts, could jeopardise not merely what is his, but what in terms of the Bill belongs to his wife.”⁹

- 31.13 The PRA’s rules relating to a partner’s protected interest are based on the Joint Family Homes Act 1964 (JFHA).¹⁰ The JFHA allows married partners to register the ownership of their home in their joint names.¹¹ The JFHA does not apply to partners in a civil union or de facto relationship. Once registered, the JFHA gives a spouse’s interest in the family home priority over the unsecured creditors of the other spouse.¹² Like the PRA, the JFHA protects a spouse’s interest in the home to the extent of a “specified sum.”¹³ The current specified sum is \$103,000.¹⁴ The specified sums under the JFHA and the PRA have been set in tandem.

Notices of claim – section 42

- 31.14 Section 42 of the PRA allows a partner with a claim or interest in land under the PRA to register a notice on the title of the land. A notice of claim has been described as a “stop sign” because when registered on the title to land it prevents dealings with the land.¹⁵ A notice of claim may affect the rights creditors claim to the land, particularly if the creditor’s interest in the land is unregistered or if it has been registered after the notice of claim is lodged.
- 31.15 Section 42(5) provides that a notice can be registered even though no PRA proceedings are pending or in contemplation. There may not even be a dispute between the partners. Section 42 therefore alters the general rules in sections 19 and 20A that the claims of a

⁹ AM Finlay “Matrimonial Property – Comparable Sharing: An Explanation of the Matrimonial Property Bill 1975” [1975] II AJHR E6 at 12.

¹⁰ When an amendment was made to the Joint Family Homes Act 1964 in 1974, the Minister of Justice, Hon Martyn Finlay, explained that he was shortly to introduce the Matrimonial Property Bill 1975 that would embody the principles of the Joint Family Homes Act 1964: (4 October 1974) 394 NZPD 4833–4834.

¹¹ The benefits of settling a home under the Joint Family Homes Act 1964 were much more significant before the enactment of the Matrimonial Property Act 1976. First, a settlement under Joint Family Homes Act did not attract gift duty. Second, the Property (Relationships) Act 1976 was not yet in force and consequently the family home was not, at that time, automatically classified as relationship property.

¹² Joint Family Homes Act 1964, s 9(2)(d).

¹³ Joint Family Homes Act 1964, s 16(5). The specified sum can be set by the Governor-General by Order in Council.

¹⁴ As set by cl 3 of the Joint Family Homes (Specified Sum) Order 2002.

¹⁵ *Moriarty v Roman Catholic Bishop of Auckland* (1982) 1 NZFLR 144 (HC) at 146. Section 42(1) of the Property (Relationships) Act 1976 (PRA) deems the alleged claim or interest to be a registrable interest under the Land Transfer Act 1952. Section 42(3) of the PRA provides that a notice, once lodged, has effect as if it were a caveat.

partner under the PRA do not affect the rights of third parties and creditors.

- 31.16 *Price v Price* is a good example of how creditors' rights may be affected.¹⁶ Mr Price borrowed money from a bank. The loan was secured by a mortgage over a house owned by Mr Price. Mr and Mrs Price separated and Mrs Price lodged a notice of claim against the title to the house. After the notice was lodged, the bank made further advances to Mr Price. When Mr Price defaulted on the mortgage, the bank sold the property through its mortgagee's power of sale. The bank applied to remove the wife's notice of claim. The issue before the High Court was what effect Mrs Price's notice of claim had on the bank's rights. The Court said that the notice of claim gave Mrs Price priority over the bank regarding the advances the bank had made after Mrs Price lodged her notice. This meant that Mrs Price could have her interest in the family home determined and given priority over the rights of the bank to recover the unpaid subsequent advances.¹⁷
- 31.17 Creditors whose rights are registered before a notice of claim is lodged can exercise their legal rights despite the notice. The position of creditors is further protected by section 46. That section provides that rights conferred on a partner by any order made under the PRA are subject to the rights of secured creditors if the security was registered before the order was made, or if the rights arise under an instrument executed before the order was made.
- 31.18 In *M v ASB Bank Limited*, one of the partners had mortgaged his property.¹⁸ The mortgage was in his sole name. In PRA proceedings, the Family Court granted the other partner an occupation order. She registered a notice of claim against the property to protect her interest under the occupation order. The non-occupant partner then ceased making payments under the mortgage (which the Court considered led to an arguable case he had engineered a default under the mortgage to defeat his former partner's rights). The bank exercised its power of mortgagee sale and sought orders removing the occupant partner's notice of claim so the sale could proceed.

¹⁶ *Price v Price* [1995] 3 NZLR 249 (HC).

¹⁷ *Price v Price* [1995] 3 NZLR 249 (HC) at 256.

¹⁸ *M v ASB Bank Limited* [2012] NZCA 103, [2012] NZFLR 641.

31.19 The Court of Appeal said that section 46 was critical. The section gave priority to the rights of a secured party under an instrument executed before an order is made. The bank's rights took priority over the partner's occupation order.¹⁹

Transactions made to defeat a partner's claim or rights under the PRA – section 43 and section 44

31.20 Sections 43 and 44 of the PRA apply where a disposition of property is about to be made (section 43) or has been made (section 44) to defeat a partner's claim or rights under the PRA. A court has power to restrain the impending disposition under section 43, or order under section 44 that property already disposed of be recovered or compensation for its value paid. A creditor may be party to a transaction intended to defeat a partner's rights under the PRA and, in such circumstances, the creditor's rights may be denied under sections 43 or 44 of the PRA.

31.21 Sections 44 does, however, protect the position of the person to whom the disposition of property is made, if the property is received in good faith and the recipient has altered his or her position in reliance of having an indefeasible interest in the property.²⁰

31.22 In *M v ASB Bank Limited*, discussed above, the bank sought to sell a mortgaged property by mortgagee sale even though the property was subject to an occupation order. The occupant partner claimed that the bank was acting with intent to defeat her rights under the PRA and the impending sale should be restrained under sections 43 and 44 of the PRA. The bank argued that its rights under section 46 should take priority. Importantly, section 46 states it is subject to sections 42 to 44. The question was whether the bank's rights under section 46 were displaced by sections 43 and 44.

31.23 The Court of Appeal said that the bank's power of mortgagee sale could not be a disposition of property under section 43 because the bank was not a party to the Family Court proceedings between the parties.²¹ Nor had it colluded with the mortgagor partner

¹⁹ *M v ASB Bank Limited* [2012] NZCA 103, [2012] NZFLR 641 at [20]-[22].

²⁰ Property (Relationships) Act 1976, s 44(4).

²¹ *M v ASB Bank Limited* [2012] NZCA 103, [2012] NZFLR 641 at [43].

to defeat the occupant partner's rights.²² As a result section 43 could not apply. Likewise, section 44 could not apply because the Court found that the bank was attempting to sell the mortgaged property to recover a debt that had fallen due.²³ It was not acting with an intention to defeat the occupant partner's rights.

- 31.24 The Court also said that, because of the bank's legitimate rights, the sale of the property could not be subject to a condition allowing the occupant partner to reside in the property until the Family Court proceedings had been determined.²⁴
- 31.25 Usually creditors will seek to exercise their rights of recovery in a similar manner to the bank in *M v ASB Bank Limited*. It may therefore be uncommon that the rights of creditors will be affected by sections 43 or 44.

Agreements to defeat creditors

- 31.26 The PRA addresses the situation where partners make an agreement between themselves regarding their property which defeats the rights of creditors. The situation is dealt with by section 47. The courts have said that because the PRA governs all transactions between the partners,²⁵ all other legislation is subject to the PRA.²⁶ The general law of insolvency will not apply in this context.²⁷ Rather, all questions about the validity of an agreement or transaction between the partners must be dealt with by section 47.
- 31.27 Section 47(1) provides that any agreement, disposition or other transaction between the partners regarding their relationship property and intended to defeat the interests of the creditors of either partner is void against those creditors and the Official Assignee. This provision is focused on the partners' intentions and whether the loss to creditors was deliberate. If section 47(1) applies, the entire agreement or transaction is void.
- 31.28 Section 47(2) focuses on the effects of the transaction rather than the partners' intentions. It provides that an agreement,

²² *M v ASB Bank Limited* [2012] NZCA 103, [2012] NZFLR 641 at [43]-[44].

²³ *M v ASB Bank Limited* [2012] NZCA 103, [2012] NZFLR 641 at [53]-[54].

²⁴ *M v ASB Bank Limited* [2012] NZCA 103, [2012] NZFLR 641 at [63].

²⁵ Property (Relationships) Act 1976, s 4.

²⁶ *Official Assignee v Williams* [1999] 3 NZLR 427 (CA).

²⁷ The general law of insolvency is primarily governed by the Insolvency Act 2006 and the Property Law Act 2007.

disposition or transaction of relationship property that had the effect of defeating creditors is void against such creditors and the Official Assignee “during the period of two years after it is made.”

- 31.29 There has been uncertainty about the meaning of the two year period referred to in section 47(2). The Supreme Court considered the issue in *Felton v Johnson*.²⁸ Mr Johnson, through a company, had entered several franchise agreements for distributing a product. Several franchisees expressed dissatisfaction, although at first no litigation was threatened against Mr Johnson personally. Mr and Mrs Johnson entered a relationship property agreement under Part 6 of the PRA. Under the agreement, Mrs Johnson took a greater share of the relationship property.²⁹ Four years later the franchisees commenced litigation against Mr Johnson personally and sought to set aside the relationship property agreement.
- 31.30 The question before the Court was whether the reference to the two year period in section 47(2) prevented the creditors from setting aside Mr and Mrs Johnson’s agreement. The Court considered two possible interpretations of section 47(2). The first was that the two year period was a limitation period, meaning affected creditors had only a two year period after the agreement was made to treat the agreement as void. The second interpretation was that the two year timeframe was a period in which to determine which creditors could treat an agreement as void. The agreement could only be set aside by a creditor if it became a creditor during the two year period after the agreement was made.
- 31.31 The Supreme Court favoured the first interpretation. The Court reasoned that an agreement would only be void if a creditor elected to treat it as void within two years of the date of the agreement.³⁰ The Court said that, as none of Mr Johnson’s creditors did anything during the two year period after Mr and Mrs Johnson made their agreement, they could not now seek to challenge the agreement under section 47(2).³¹

²⁸ *Felton v Johnson* [2006] NZSC 31, [2006] 3 NZLR 475.

²⁹ Mrs Johnson took most of the partners’ assets whereas Mr Johnson took shares in the company. If the shares had been properly valued, the imbalance in the property each partner took was in excess of \$550,000.

³⁰ *Felton v Johnson* [2006] NZSC 31, [2006] 3 NZLR 475 at [21]. The Supreme Court held at [20] that s 47 of the Property (Relationships) Act 1976 (PRA) was an adaptation of the historic law that applied to transactions that defeated creditors’ rights (namely, the Statute of Elizabeth 1571 and the Property Law Act 1952). The historic law was liable to be set aside when challenged by an affected creditor. The agreement was not to be treated as void ab initio. The Supreme Court held that s 47(2) of the PRA was to be interpreted the same way: an agreement could only be treated as void if a creditor elected to treat an agreement as void.

³¹ *Felton v Johnson* [2006] NZSC 31, [2006] 3 NZLR 475 at [23].

- 31.32 The courts have said that an agreement will defeat creditors only if the agreement moves property between the partners in such a way as to deplete the resources of one partner available to creditors.³² If a partner has provided money or other property of the same value as the property he or she has received from the other partner, the effect of the agreement will not defeat creditors. The creditors will have the same total resources of the partner available to them as they had before.³³
- 31.33 Section 47(3) provides that when the partners have separated and entered an agreement under the PRA to settle their rights to property, the agreement is “deemed to have been made for valuable consideration.”³⁴

Issues with the way the PRA treats the rights of creditors

General policy of the PRA

- 31.34 The general policy of the PRA is that the rights of creditors should remain largely unaffected by the operation of the PRA, except for limited exceptions. Through our research and preliminary consultation, we have found little criticism of the general priority given to creditors under the PRA.
- 31.35 There are obvious merits to upholding creditors’ rights. Usually creditors will be independent third parties who have provided goods or services to either or both partners. In return for the value they have provided, creditors will expect payment under the contractual agreement they have entered. Pending payment, creditors will sometimes receive rights to security. It is arguably unfair that, having benefitted one or both partners, the creditor should have his or her rights affected.
- 31.36 Any amendment to the PRA that alters creditors’ rights could have significant implications. If the rights of creditors under the PRA

³² *Neill v Official Assignee* [1995] 2 NZLR 318 (CA) at 323 per Richardson J.

³³ *Neill v Official Assignee* [1995] 2 NZLR 318 (CA) at 323 per Richardson J.

³⁴ Consideration means the exchange of a right or benefit in return for what the giver obtains under the contract. In contract law, consideration is an essential element for a contract to be binding.

are diminished when partners separate, it is reasonable to assume that lenders' credit practices would change.

- 31.37 An absolute priority for creditors' rights may, however, cause unfairness in certain circumstances. *M v ASB Bank Ltd* (discussed above) exemplifies particular difficulties that may arise.³⁵ There the Court said the bank's right to sell the mortgaged property took priority over the partner's right to occupy the house even though she had been granted those rights by a Family Court order.
- 31.38 The PRA attempts to address the potential unfairnesses in some cases by apportioning the debt between the partners through the division of the relationship property, but this may be a hollow remedy. For example, partners may incur personal debts for which both are jointly liable, such as credit cards linked to a joint bank account. Under the PRA's rules, the bank may hold each partner jointly liable for the credit card debt. In those circumstances, section 20E may apply. It provides that where one partner has paid a personal debt from relationship property, the court may order that the other partner receive compensation or a greater share of relationship property. This may be an adequate remedy for partners with sufficient relationship and separate property at their disposal from which to pay compensation. However, for other partners their property will be insufficient and the only meaningful remedy a partner can enjoy is to be relieved of liability to the creditor in respect of the other partner's personal debts.
- 31.39 Despite these issues, we know that any changes to the PRA's provisions regarding the rights of creditors should not be made lightly. We therefore seek submissions on whether the way the PRA treats creditors is appropriate, or if any specific problems justify reform.

CONSULTATION QUESTION

K1 Is the way the PRA treats creditors appropriate or are there specific problems that justify reform?

Role of the Joint Family Homes Act 1964

- 31.40 There is considerable overlap between the PRA and the JFHA. The PRA classifies the family home as relationship property.³⁶ This

³⁵ *M v ASB Bank Limited* [2012] NZCA 103, [2012] NZFLR 641.

³⁶ Property (Relationships) Act 1976, s 8(1)(a).

classification recognises the home as the joint property of the partners. It is a very similar result to registering a home under the JFHA. Likewise, the PRA adopts the protected interest scheme from the JFHA.

- 31.41 The Law Commission reviewed the JFHA in 2001 and recommended that it be repealed.³⁷ The Commission noted how the overlap with the PRA had led to the “evaporation” of many of the original benefits under the JFHA.³⁸ The Commission gave additional reasons for recommending repeal, including:³⁹
- (a) the protection against creditors was of little practical use as most homes registered under the JFHA were mortgaged and the rights of secured creditors remained unaffected;
 - (b) the fixed specified sum resulted in geographical inequality and often fell short of providing the equity for a home of a reasonable minimum standard;⁴⁰
 - (c) the Commission reported a significant decrease in the number of registrations under the JFHA in the years preceding its report;
 - (d) it was open for the partners to use other devices to protect the home, like a trust; and
 - (e) the JFHA was arguably discriminatory as it did not apply unless the partners were married.⁴¹
- 31.42 Since the Commission’s report, the removal of gift duty has also reduced the benefits of settling homes under the JFHA.⁴²
- 31.43 The issues with the JFHA continue. In recent years, the rate of registrations under the JFHA has further decreased (although some married partners do continue to register their homes under the JFHA).⁴³

³⁷ See Law Commission *The Future of the Joint Family Homes Act* (NZLC PP44, 2001); and Law Commission *The Future of the Joint Family Homes Act* (NZLC R77, 2001).

³⁸ Law Commission *The Future of the Joint Family Homes Act* (NZLC PP44, 2001) at [17].

³⁹ Law Commission *The Future of the Joint Family Homes Act* (NZLC R77, 2001) at [8] and [15].

⁴⁰ Law Commission *The Future of the Joint Family Homes Act* (NZLC R77, 2001) at [9].

⁴¹ Law Commission *The Future of the Joint Family Homes Act* (NZLC R77, 2001) at [12].

⁴² Gifts made after 1 October 2011 have not attracted gift duty: Taxation (Tax Administration and Remedial Matters) Act 2011, s 245.

⁴³ In 2012, the Joint Family Homes Repeal Bill 2012 (2-1) was introduced to Parliament as a Member’s Bill. In addition to the reasons given by the Law Commission, the reasons given in the explanatory memorandum of the Bill for repealing the Joint Family Homes Act 1964 included the low rate of registrations. The decrease in registrations suggested little

- 31.44 In 2012, the Joint Family Homes Repeal Bill 2012 was introduced to Parliament as a Member's Bill. The Bill was not enacted. The Parliamentary select committee that considered the Bill reported that it should not be passed because there needed to be a mechanism of preserving the rights under the approximately 36,000 existing registrations.⁴⁴
- 31.45 We recognise that the continued existence of the JFHA is not critical to our review of the PRA. We nevertheless question its continued place in the statute books. The reasons for which the Law Commission previously recommended the repeal of the JFHA remain valid.

Should there be a protected interest in the family home?

- 31.46 The philosophy behind the protected interest in the family home is that one partner's share of relationship property should not be seized to satisfy the purely personal creditors of the other partner.⁴⁵ Our preliminary view is that the PRA should continue to provide partners with a protected interest in some form. The protected interest recognises that a partner's rights and interests under the PRA should prevail against the rights of the other partner's unsecured creditors to the extent of that protected interest. This philosophy is implemented in the PRA by granting a partner priority in the family home to the lesser of half its equity or the specified sum of \$103,000.⁴⁶ Several issues arise in the way the protected interest attaches to the family home.

support for the scheme: see Joint Family Homes Repeal Bill 2012 (2-1) (select committee report) at 2. In recent years, the number of registrations of joint family homes under the Act have been as follows: 2007: 424 registrations; 2008: 354 registrations; 2009: 294 registrations; 2010: 292 registrations; 2011: 187 registrations; 2012: 164 registrations; 2013: 114 registrations; 2014: 127 registrations; 2015: 94 registrations; and 2016: 86 registrations: email from Land Information New Zealand to the Law Commission regarding data on joint family home registrations under the Joint Family Homes Act 1964 (1 May 2017).

⁴⁴ In its report, the Law Commission recommended that Parliamentary Counsel consider whether the repealing statute should include express provision to the effect that, upon repeal, the settled property shall remain vested in the husband and wife as joint tenants, but none of the other effects of registration as a joint family home constitutes an existing right, interest, title, immunity, or duty within the meaning of s 18 of the Interpretation Act 1999: Law Commission *The Future of the Joint Family Homes Act* (NZLC R77, 2001) at [22].

⁴⁵ AM Finlay "Matrimonial Property – Comparable Sharing: An Explanation of the Matrimonial Property Bill 1975" [1975] II AJHR E6 at 12.

⁴⁶ Property (Relationships) Act 1976, s 20B.

Rates of home ownership are decreasing

31.47 The rate of home ownership in New Zealand has been in decline since 1991, when it peaked at 74 per cent.⁴⁷ In the 2013 census, 64.8 per cent of households responded that they owned their home.⁴⁸ The decline in home ownership over the last 25 years has been attributable to a range of factors that have seen house prices increase at a rate that has outpaced rises in average household income.⁴⁹

31.48 Sections 11B, 20B(1)(b) and 20B(3) attempt to provide for a protected interest when the partners have no family home.⁵⁰ Section 11B provides that where there is no family home, or the home is not owned by either partner, the court must award each partner an equal share in the relationship property “as it thinks just to compensate for the absence of the family home.” Section 20B(1)(b) then provides that a partner’s protected interest applies to the property shared under section 11B.

31.49 The fundamental difficulty is that section 11B is very unlikely to apply when creditors claim against the partners’ relationship property. This is for two reasons. First, the court will make a compensatory order under section 11B only when a partner applies for division orders under section 25. If the partners have not separated neither partner would seek an order under section 11B. Second, in the ordinary course of property division, there seems little point in section 11B because all relationship property is divided equally in any event.⁵¹ Even if the partners separated and one partner had applied for division under section 25, the court would seldom, if ever, make a compensatory award of relationship property under section 11B.

⁴⁷ Law Commission *Relationships and Families in Contemporary New Zealand: He hononga tangata, he hononga whānau i Aotearoa o nāianei* (NZLC SP22, 2017) at Chapter 7.

⁴⁸ Law Commission *Relationships and Families in Contemporary New Zealand: He hononga tangata, he hononga whānau i Aotearoa o nāianei* (NZLC SP22, 2017) at Chapter 7.

⁴⁹ Law Commission *Relationships and Families in Contemporary New Zealand: He hononga tangata, he hononga whānau i Aotearoa o nāianei* (NZLC SP22, 2017) at Chapter 7.

⁵⁰ Section 20B(1)(a) of the Property (Relationships) Act 1976 also provides that where the family home has been sold, a partner has a protected interest in the sale proceeds. As the proceeds of sale are relatively easy to identify (at least in cases where there has been no intermingling), section 20B(1)(a) is easier to apply than section 20B(1)(b).

⁵¹ This observation was made by the Family Court in *P v P* [2003] NZFLR 925 (FC) at [106]. The provision appears to have endured from the Matrimonial Property Act 1976 prior to its amendment in 2001. The former iteration of the rules of division prior to 2001 provided that the family home and family chattels were to be divided equally, whereas the remainder of the partners’ relationship property was to be divided in accordance with their contributions: Matrimonial Property Act 1976, s 11. It therefore made sense that the partners were to share equally in an amount of substitute relationship property.

- 31.50 Nevertheless, section 20B(1)(b) provides that, where section 11B applies, a partner has a protected interest in “the property shared under that section.” If the court has not ordered that property be shared under section 11B, there would be no property to which the protected interest will attach.
- 31.51 As home ownership looks to be decreasing, and because the protected interest is unlikely to apply when the partners have no family home, its benefits will apply to fewer partners. There is arguably an anomaly that the PRA confers greater protections on some partners simply because their partners have invested in a home rather than other types of property.

The ‘specified sum’ is inadequate and leads to geographical inequalities

- 31.52 The value of a partner’s protected interest in the family home under section 20B of the PRA is the lesser of the “specified sum” (currently \$103,000) or half the equity in the family home.⁵²
- 31.53 It is not clear on what basis the specified sum is calculated.⁵³ It appears, however, that the specified sum under the PRA should fulfil the same role as the specified sum under the JFHA.⁵⁴ Case law under the JFHA has established that the purpose of the specified sum is to represent the equity required for a house of a reasonable minimum standard.⁵⁵ The specified sum under the PRA is probably intended to represent the same value.
- 31.54 The specified sum was set in 2002. It has not been increased even though the equity required for a house of a reasonable minimum standard in New Zealand today has increased markedly since 2002. Since mid-2012 alone, nationwide house prices have risen over 33 per cent (which has been underpinned to a large degree by rapid house price inflation in Auckland and post-earthquake accommodation shortages in Christchurch).⁵⁶

⁵² Property (Relationships) Act 1976, s 20B(3).

⁵³ There is little indication of the specified sum’s purpose in the legislative materials to the enactment and amendment of the Property (Relationships) Act 1976.

⁵⁴ The specified sum for the purposes of the Joint Family Homes Act 1964 is \$103,000: Joint Family Homes (Specified Sum) Order 2002, cl 3. The specified sum under both Acts is the same and they were set at the same time.

⁵⁵ *Official Assignee v Lawford* [1984] 2 NZLR 257 (CA) at 265 per Cooke J.

⁵⁶ Elizabeth Kendall *New Zealand house prices: a historical perspective* (Reserve Bank of New Zealand, Bulletin 79(1), January 2016) at 3.

- 31.55 When the Law Commission considered the adequacy of the specified sum in its review of the JFHA in 2001, the Commission criticised the specified sum for taking no account of the regional differences of housing costs.⁵⁷ The regional differences in housing costs are likely to be greater in New Zealand today. The Reserve Bank reported that, between mid-2012 and January 2016, Auckland house prices increased by 52 per cent, but house prices in the rest of New Zealand increased by only 11 per cent.⁵⁸ By the end of 2015, house prices in Auckland were roughly double house prices in the rest of New Zealand (although other urban centres such as Wellington also have relatively high house prices).⁵⁹
- 31.56 In considering a better approach, the Law Commission concluded that it would be impossible to devise a specified sum that was suitable nationwide.⁶⁰ The Commission also rejected a submission that the specified sum be based on the percentage of the net value of a property. The Commission said it was difficult to justify an arrangement that would “reward the conspicuous consumption of a crashed commercial high-flyer more generously than the modest housing expenditure of a small tradesman.”⁶¹
- 31.57 In advice to the Parliamentary select committee considering the 2001 amendments, the Ministry of Justice said that the difficulties of basing the specified sum on a percentage may cause partners to misuse the protections to defeat the interests of creditors.⁶² The Ministry explained that partners may prioritise building the equity in the family home to maximise the non-debtor spouse’s protected interest. They might for example purchase a home more expensive than they reasonably need. They may have an incentive to repay their mortgage at a faster rate or spend money on improvements to the home at the expense of other creditors.
- 31.58 We consider these issues are significant. If the specified sum should represent the equity required for a house of a reasonable minimum standard, there are real questions as to whether this can be achieved, particularly in way that is fair nationwide.

⁵⁷ Law Commission *The Future of the Joint Family Homes Act* (NZLC R77, 2001) at [15].

⁵⁸ Elizabeth Kendall *New Zealand house prices: a historical perspective* (Reserve Bank of New Zealand, Bulletin 79(1), January 2016) at 12.

⁵⁹ Elizabeth Kendall *New Zealand house prices: a historical perspective* (Reserve Bank of New Zealand, Bulletin 79(1), January 2016) at 11.

⁶⁰ Law Commission *The Future of the Joint Family Homes Act* (NZLC R77, 2001) at [15].

⁶¹ Law Commission *The Future of the Joint Family Homes Act* (NZLC R77, 2001) at 8.

⁶² Ministry of Justice *Matrimonial Property Amendment Bill – Departmental Report Clause by Clause Analysis* (Ministry of Justice, MPA/MJ/4, 2 March 1999) at 16–17.

The family home will often be mortgaged

31.59 The protected interest may seldom apply often because it does not take priority over secured creditors. As the Law Commission observed in its review of the JFHA, the effectiveness of the protected interest provided by the JHFA is limited because it only prevails above the claims of unsecured creditors.⁶³ Likewise, the protected interest under section 20B of the PRA only applies against unsecured creditors. It is possible that, where one partner is heavily indebted and facing recovery action from creditors, the family home will already be mortgaged in respect of those debts. In those circumstances, the protected interest may be of little use. There have been few cases where a partner's protected interest has been an issue for the court to consider. This suggests that the protected interest is seldom invoked.

Should the approach to classification of relationship property be changed?

31.60 In Part C we consider whether the PRA's approach to the classification of relationship property should be amended. We contemplate whether the current approach under which the family home is classified as relationship property (the "family use" approach) should be changed. Instead, we consider whether an approach that focused on property that the partners acquired during or as a result of the relationship (the "fruits of the relationship" approach) would be a better way to classify relationship property.

31.61 If the PRA's definition of relationship property was reformed to a "fruits of the relationship" approach, the family home would no longer automatically be designated as relationship property. Consequently, the protected interest provisions under section 20B would also need amendment.

Should the protected interest continue to apply to the family home?

31.62 Despite the problems with attaching a partner's protected interest to the family home, for many partners the family home is likely to continue to be the partners' principal asset. Similarly, the

⁶³ Law Commission *The Future of the Joint Family Homes Act* (NZLC R77, 2001) at [8].

home is likely to be a significant source of property from which to satisfy creditors' claims. There may be good reason to single out the family home as an asset deserving special protection, such as the importance of the home to children.⁶⁴ Furthermore, it may be simpler to identify the extent of a partner's interest in a home rather than in a less discernible global pool of relationship property.

- 31.63 On the other hand, in light of the problems we have identified with the protected interest attaching to the family home, reform may be required. It may be better that a partner's protected interest should apply to all types of relationship property. That will probably be necessary if the PRA's approach to the classification of relationship property is changed. If a partner's protected interest is to apply to relationship property generally, consideration will need to be given to the appropriate extent of the protected interest.

CONSULTATION QUESTIONS

- K2 Should the PRA continue to provide a partner with a protected interest that takes priority against the other partner's unsecured creditors?
- K3 If so, should the protected interest apply to the family home or to relationship property generally?
- K4 What should be the extent of the protected interest?

Is the section 42 notice of claim procedure adequate?

- 31.64 Section 42 is a significant provision. It is one of the major exceptions to the general rules on which the PRA is built. In particular, a partner can register a notice under section 42 at any point during the relationship, despite the rule that partners' rights under the PRA are deferred until they separate and their property is divided. As a notice under section 42 can prevent dealings with land, it can affect the rights of creditors whose claims against the

⁶⁴

It should be noted that the protected interest is not directly targeted at ensuring partners retain occupation rights to the same house. The protected interest provisions do not grant a partner a right to occupy the family home; rather, the provisions ensure that a partner can access some equity for an alternative home. The protected interest therefore proceeds on the basis that the home itself would be sold and the sale proceeds divided among the partner and unsecured creditors.

land have not been registered prior to the notice under section 42.⁶⁵

- 31.65 We observe in Part D that the notice of claim procedure appears to be widely used, and that, despite the significance of section 42, we have encountered little criticism with the notice of claim procedure.⁶⁶ The policy reason for section 42 and the consequences that notices of claim have for third parties appear, from our research and preliminary consultation, to be largely accepted.
- 31.66 Any criticisms focus on the fact that section 42 is another instance where the PRA gives partners' interests in the family home special protections that are not available in respect of other property.⁶⁷ As we have commented elsewhere in this Part, the way the PRA gives special protections to the family home may be arbitrary, particularly as rates of home ownership in New Zealand are decreasing.⁶⁸

CONSULTATION QUESTION

K5 Should the PRA continue to provide partners with the ability to lodge notices of claim in respect of land in which they claim an interest? Why or why not?

Difficulties in applying section 47(2)

- 31.67 In *Felton v Johnson*, the Supreme Court said the reference to the two year period in section 47(2) should be interpreted as a limitation period. Creditors must challenge an agreement within a two year period after the agreement is made if the agreement

⁶⁵ Although, as the authors of *Fisher on Matrimonial and Relationship Property* note, a notice of claim may be of less consequence than it at first appears because the notice of claim procedure does not create a formula for determining substantive rights between the partners, or substantive rights with third parties: RL Fisher (ed) *Fisher on Matrimonial and Relationship Property* (online looseleaf ed, LexisNexis) at [9.19].

⁶⁶ However, as discussed in Part D, there are some areas of uncertainty in how the notice of claim procedure applies to certain types of property. In particular, some cases have dealt with the issue of when a notice of claim can be supported by an interest a partner claims in a trust under which the other partner is a beneficiary: see *H v JDVC* [2015] NZCA 213. There has also been uncertainty about whether a partner can register a caveat as an alternative to a notice of claim. This point appears to have been largely resolved in the decision *Huang v Chung* [2015] NZHC 686, (2015) 30 FRNZ 188. The High Court at [18]–[22] explained how the two procedures are conceptually distinct. A caveat may only be supported if the party lodging the caveat has an existing proprietary claim to the land. A notice of claim, on the other hand, supports a partner's inchoate rights to the land which will only be enjoyed once a court grants orders dividing the land under the Property (Relationships) Act 1976 (PRA). Consequently, a right under the PRA was essentially a future interest which could not be used to support a caveat.

⁶⁷ We note, though, that land is distinct because it is already subject to a registration system under the Land Transfer Act 2017. It is therefore more practical for a partner to register a notice of interest in respect of land than it is in relation to other types of property that are not subject to a registration system.

⁶⁸ See above at paragraphs [31.47]–[31.51].

is to be void against affected creditors. This interpretation raises several potential issues.

- 31.68 The first issue is that a two year limitation period may disadvantage creditors. Many creditors will be unaware that partners have entered an agreement until after the period has expired.⁶⁹ This will primarily disadvantage unsecured creditors because if partners dealt with security in a prejudicial way it would breach the security agreement and creditors in those cases would have rights under the agreement.
- 31.69 Creditors may not have been creditors when the relevant agreement was made. Involuntary creditors, as in *Felton v Johnson*, must first obtain judgment against the partner or partners.⁷⁰ That may take months, if not years. The partners may also conceal their agreement. We expect that an agreement that is prejudicial to creditors would often come to light during debt recovery proceedings or after a partner's bankruptcy. Consequently, although the agreement has a prejudicial effect when made, the adverse consequences may not manifest until much later.⁷¹ The two year limitation period is likely to restrict the effectiveness of section 47(2) and therefore limit the redress available for creditors.⁷²
- 31.70 Section 47(2) is different to the position under general insolvency law. Sections 194 and 195 of the Insolvency Act 2006 provide that the Official Assignee may cancel transactions that prefer one creditor over others when a debtor is insolvent. The transaction must be made within two years immediately before the person who made the transaction was adjudicated bankrupt. Under these provisions, affected creditors benefit from the cancellation of the transaction without having to bring proceedings within a strict time limit as they do under section 47(2) of the PRA.⁷³ General insolvency law is arguably more favourable to creditors.

⁶⁹ This point was raised by Young J in his dissenting judgment in the Court of Appeal decision *Johnson v Felton* [2006] 3 NZLR 475 (CA) at [67] and [92].

⁷⁰ See for example *Ministry of Education v M* [2017] NZHC 47 where the employer creditor applied to the court under s 47 of the Property (Relationships) Act 1976 to have the separation agreement declared void. The creditor only applied after the wife had been convicted of criminal wrongdoing having stolen \$170,000 from her employer.

⁷¹ *Neill v Official Assignee* [1995] 2 NZLR 318 (CA) at 322 per Richardson J.

⁷² The creditors' right of recovery under s 47(1) of the Property (Relationships) Act 1976 is not time-bound in the same way. However, we believe that it will be difficult in many cases for creditors to prove that the partners intended to defeat their rights when entering an agreement or transaction. Section 47(2) is therefore likely to be a much more useful remedy and this usefulness is severely restricted by the imposition of a two year limitation period.

⁷³ Elizabeth Tobeck "Relationship Property and Creditors" [2006] NZLJ 413 at 416.

- 31.71 The policy basis for why section 47(2) grants creditors lesser rights than they enjoy under general insolvency law is unclear. The position taken in section 47(2) contradicts the position taken in section 20A of the PRA that creditors of either or both partners continue to enjoy rights as if the PRA had not been passed.
- 31.72 There may, however, be good reasons to limit creditors' rights when it comes to setting aside partners' agreements. Partners will want confidence that the agreements they reach with one another can be relied upon. A limitation period for setting aside an agreement ensures it cannot be challenged after the period has elapsed. Moreover, there may be situations where a partner's rights to relationship property are more deserving than those of unsecured creditors. For example, a partner may have devoted years of service to the relationship by caring for children, maintaining a home, and supporting the other partner in his or her career. That partner may have a stronger moral claim to items of relationship property than, say, an unpaid supplier in relation to the other partner's separate affairs.⁷⁴ The unpaid supplier could have contracted to take security regarding the debt but may have chosen not to. The partner may have contributed, in both a tangible and intangible way, greater value to the property he or she takes under the agreement than the supplier.
- 31.73 The second potential difficulty with section 47(2) concerns more practical issues. The Supreme Court in *Felton v Johnson* was uncertain how the limitation period would apply to the Official Assignee.⁷⁵ The Court held that a creditor could challenge an agreement within the two year limitation period by bringing proceedings under section 47(2) or by seeking to enforce a court judgment against the property which is the subject of the agreement.⁷⁶ The Supreme Court said the position of the Official Assignee was a "matter of considerable difficulty."⁷⁷ It was unclear whether section 47(2) simply required that the partner be adjudicated bankrupt within the two year period or whether the Official Assignee must take some other step to invoke section 47(2).⁷⁸

⁷⁴ Although we note that the partner will have the protected interest in the family home under s 20B of the Property (Relationships) Act 1976 which will take priority over the unsecured creditor.

⁷⁵ *Felton v Johnson* [2006] NZSC 31, [2006] 3 NZLR 475 at [24].

⁷⁶ *Felton v Johnson* [2006] NZSC 31, [2006] 3 NZLR 475 at [21].

⁷⁷ *Felton v Johnson* [2006] NZSC 31, [2006] 3 NZLR 475 at [24].

⁷⁸ *Felton v Johnson* [2006] NZSC 31, [2006] 3 NZLR 475 at [24].

- 31.74 It is also uncertain whether and to what extent a claim by the Official Assignee displaces the claims of individual creditors.⁷⁹ The High Court partially addressed the issue in *Official Assignee of X (Bankrupt) v Y*.⁸⁰ There the Official Assignee sought to set aside an agreement between the partners. The High Court accepted that the partners' agreement had the effect of defeating creditors and held that section 47(2) applied. The Official Assignee had issued proceedings shortly before the expiry of the two year period so there was no issue as to what steps the Official Assignee needed to have taken to come within the two year limitation period. Nevertheless, there was an issue as to on whose behalf the Official Assignee could seek to hold the partners' agreement void. The Official Assignee sought to recover from the non-bankrupt partner an amount to meet the claims of several of the bankrupt's creditors, including its own costs. The High Court held that the agreement was only void against creditors with claims within the two year period. The creditors whose claims arose afterwards could not be said to have had their interests prejudiced or defeated by the partners' agreement.
- 31.75 The Supreme Court concluded its judgment in *Felton v Johnson* by recommending legislative attention to section 47.⁸¹ While very few cases have come before the courts, meaning the adequacy of section 47(2) has not been tested outside *Felton v Johnson*, we agree that legislative attention is necessary. We consider options for reform below.

CONSULTATION QUESTION

K6 Should section 47(2) continue to operate as a limitation period so that creditors must challenge an agreement within a two year period after the agreement was made? Why/why not?

Options for reform of section 47(2)

- 31.76 There are several forms an amendment to section 47 could take.

⁷⁹ *Felton v Johnson* [2006] NZSC 31, [2006] 3 NZLR 475 at [24].

⁸⁰ *Official Assignee of X (Bankrupt) v Y* [2017] NZHC 1117, [2017] NZFLR 320.

⁸¹ *Felton v Johnson* [2006] NZSC 31, [2006] 3 NZLR 475 at [24].

Option 1: Remove section 47 from the PRA

- 31.77 A fairly extreme option is for section 47 to be omitted from the PRA. Instead, the ordinary rules under the general law of insolvency would apply.⁸² Agreements or transactions made with intent to prejudice creditors could be dealt with under Subpart 6 of Part 6 of the Property Law Act 2007. Agreements or transactions with the effect of defeating creditors could be dealt with under sections 194 and 195 of the Insolvency Act 2006. By removing section 47 and relying on the general law of insolvency, the law would arguably be brought into line with the PRA's general position that creditors' rights continue as if the PRA had not been passed. The uncertainties and difficulties with sections 47(2) and 47(3) would also cease to exist.
- 31.78 The general law of insolvency, however, gives no additional protections to partners. There is no recognition of the particular interest a partner might have under the PRA in the property which is the subject of an agreement or transaction between the partners. For example, consideration would need to be given as to whether the provisions of the Property Law Act 2007 or the Insolvency Act 2006 should be subject to the PRA's protected interest provisions, and if so, how.

Option 2: Amend section 47(2)

- 31.79 Section 47 could be retained but several possible amendments to section 47(2) could be made.
- 31.80 First, section 47(2) could be amended so that:
- (a) the meaning of the two year period is made explicit;
 - (b) the steps the Official Assignee must take to challenge an agreement are set out; and
 - (c) if the Official Assignee intervenes, the effect that would have on the position of other creditors is clarified.
- 31.81 Second, section 47(2) could clarify that the period is a limitation period, as determined by the Supreme Court in *Felton v Johnson*. Alternatively, section 47(2) could be harmonised with the Insolvency Act 2006 by providing that an agreement or

⁸² Elizabeth Tobeck "Relationship Property and Creditors" [2006] NZLJ 413 at 414-416.

transaction could be challenged if it is made within the two year period prior to a partner's bankruptcy.

CONSULTATION QUESTION

K7 What is the best option for the reform of section 47(2)? Are there other preferable options we have not identified?

The effect of section 47(3) is unclear

31.82 Section 47(3) provides that an agreement made for the purpose of settling the partners' rights under the PRA⁸³ is "deemed to have been made for valuable consideration" for the purposes of section 47(2). The term "consideration" means the exchange of a right or benefit in return for what the giver obtains under the contract.

31.83 Section 47(3) was introduced to the PRA during the 2001 amendments. It was based on a recommendation made by the New Zealand Law Society to the Parliamentary select committee.⁸⁴ The Law Society said that creditor's interests needed to be balanced against the partners' PRA rights. It explained that when partners have separated, their PRA rights will have accrued and, in those circumstances, their position against creditors should be strengthened. Creditors and the Official Assignee should still be able to challenge the validity of transactions between partners made for inadequate consideration. The select committee accepted amendment was required to presume that a settlement agreement entered when the partners had separated was made for consideration.⁸⁵ It added that the adequacy of the consideration would still be a matter for a court.⁸⁶

31.84 The practical effect of section 47(3) is, however, unclear:

- (a) First, section 21K already provides that all contracting out agreements are "taken to have been made for

⁸³ It is unclear whether the agreements referred to in s 47(3) of the Property (Relationships) Act 1976 are settlement agreements under s 21A or include agreements under both s 21 and s 21A. The use of the word "settlement" suggests that the agreement has been entered under s 21A. Also, s 47(3)(a) provides that the agreement must have been entered when "a situation described in section 25(2) has arisen", namely the partners have ceased to live together. Nicola Peart (ed) *Brookers Family Law – Family Property* (online looseleaf ed, Thomson Reuters) says at [PRA 21A.01]:

In contrast to a contracting out agreement [under s 21] which is entered into prior to, or during a relationship, an agreement under s 21A is entered into between the partners after a relationship has ended ... The purpose of a separation agreement [under s 21A] is to record and formalise the division of property at the end of a relationship.

⁸⁴ Matrimonial Property Amendment Bill 1999 (109-2) at xi-xii.

⁸⁵ Matrimonial Property Amendment Bill 1999 (109-2) at xii.

⁸⁶ Matrimonial Property Amendment Bill 1999 (109-2) at xii.

valuable consideration.”⁸⁷ It is unclear whether section 47(3) means something different to section 21K. If it has the same meaning, section 47(3) may be redundant.⁸⁸

- (b) Second, regardless of section 47(3), creditors must always show that consideration is inadequate. Section 47(2) is concerned with agreements that deprive partners of property in a way that defeats unsecured creditors. An agreement for adequate consideration will not have that effect because it does not reduce the value of the partner’s property.⁸⁹ If section 47(3) was intended to require creditors to prove the inadequacy of consideration it may be redundant because creditors already bear that onus under section 47(2).
- (c) Third, it is unclear why deeming agreements to be for “valuable consideration” is relevant to section 47(2). Courts have said that the term “valuable consideration” can be less than the actual value of the property under consideration.⁹⁰ However, section 47(2) is only concerned with whether an agreement was for adequate consideration. Whether an agreement is made for valuable consideration or not is irrelevant.⁹¹ An agreement can be deemed to be for valuable consideration but still defeat creditors.

Options for the reform of section 47(3)

31.85 Before we consider options for the reform of section 47(3), it is first necessary to ask whether the basis for the provision is sound. Section 47(3) seeks to strengthen the rights of partners who have separated and negotiated a settlement of their relationship

⁸⁷ It is likely that the agreements referred to in s 47(3)(b) of the Property (Relationships) Act 1976 are settlement agreements within the meaning of s 21A. If an agreement purported to be a settlement agreement but did not comply with s 21A nor the requirements of s 21F, it would likely have no effect under s 21M.

⁸⁸ Section 21K(2) does, however, have the additional purpose of stating that, even though an agreement is deemed to be for consideration, it does not affect whether a disposition of property is a gift for the purposes of the Estate and Gift Duties Act 1968.

⁸⁹ That is because if under the agreement the partner has received the same value as consideration for the property he or she relinquished, the creditors will not be deprived of rights to that value: *Neill v Official Assignee* [1995] 2 NZLR 318 (CA) at 323 per Richardson J.

⁹⁰ *Welch v Official Assignee* [1998] 2 NZLR 8 (CA) at 12.

⁹¹ In *Official Assignee v Y* [2017] NZHC 1117, [2017] NZFLR 320 at [64] the High Court found that although the settlement agreement reached between the partners constituted a “mutually satisfying compromise which met their shared and individual interests”, that was not the analysis called for by s 47(2).

property affairs in order to achieve an appropriate balance with creditor's interests (see paragraph 31.83). If the partners' PRA rights have crystallised because they have separated, to what extent should those rights rank above those of creditors?

- 31.86 We briefly set out some considerations for and against the basis for section 47(3). In this context we consider only the unsecured creditors of one partner. Secured creditors should not lose rights to secured property by section 46. Section 47(1) should also remain unaffected. We are only concerned with agreements made in good faith that affect creditors for the purposes of section 47(2).
- 31.87 If a partner's PRA rights are based on the contributions he or she makes to the relationship, it would seem arbitrary to provide partners who have separated with greater rights than those who have not. Contributions to the relationship exist in either scenario. Also, any priority given to the rights of partners who have separated would be a significant qualification to the rule in section 20A that creditors have the same rights as if the PRA had not been enacted.
- 31.88 An agreement may provide benefits to the partners and their creditors even if the agreement does not involve an exchange of property of equal value. Take these examples, where the partners may agree that:
- (a) one partner retains assets which allow him or her to continue a business without interruption and the other partner takes additional property in compensation;
 - (b) the partner who cares for the children takes a greater share of property to recognise that he or she is not free to continue employment and earn income;
 - (c) the partner who moves out of the family home and relocates to a different neighbourhood takes a greater share of property to compensate for the inconvenience and upheaval of moving;
 - (d) the partner who gives up property to which he or she had significant sentimental attachment (such as a pet, painting or home) receives additional property as compensation;

- (e) the partner who takes property that cannot be accurately valued because the value fluctuates (such as foreign currency or shares in a publicly listed company) receives additional property to compensate for the valuation risk.

31.89 In each scenario one partner is deprived of property which may affect the rights of his or her creditors. The bargain should, however, not be lightly overturned because:

- (a) the partner may receive many advantages that indirectly benefit creditors, such as allowing a partner to retain business assets so his or her business and income stream can continue without interruption;
- (b) creditors will often benefit from the stability and certainty a settlement agreement provides as opposed to the costs and uncertainty of a dispute; and
- (c) a partner may accept significant burdens in order to receive a greater share of property, such as child care responsibilities. It is doubly hard on that partner (and the children) if they are left with the burdens under the agreement but the benefits are taken from them to satisfy creditors' claims.

CONSULTATION QUESTIONS

K8 Should a partner's rights under a settlement agreement take priority over the rights of unsecured creditors for the purposes of section 47(2)? If so, why?

K9 Are there any circumstances in which a partner's rights should or should not take priority?

Option 1: Remove section 47(3)

31.90 If a partner's rights under a section 21A settlement agreement should not take priority over the rights of the other partner's unsecured creditors, then the clear option is to remove section 47(3) from the PRA. Currently the provision seems to serve no useful purpose. If section 47(3) was removed, the amendment would be insignificant as it would simply remove a provision with no practical effect.

Option 2: Rely on general insolvency law

31.91 If a partner's rights should prevail against creditors, one option is to replace section 47(3) with the defences provided under insolvency law. Under the Insolvency Act 2006, a court must not order recovery from a person who receives property if the recipient:⁹²

- (a) received the property in good faith from the bankrupt;
- (b) did not suspect the person who provided the property was insolvent; and
- (c) gave value for the property or altered his or her position in the reasonably held belief that the transfer of the property was valid and would not be cancelled.

31.92 Such a provision could be brought into section 47 as a defence to section 47(2). That would mean a partner who provided value or altered his or her position could take advantage of the defence even if he or she did not provide adequate consideration.

31.93 Alternatively, we have considered whether sections 47(1) and 47(2) should be reformed by removing section 47 from the PRA entirely. Instead, the general irregular transaction provisions of insolvency law could apply. If general insolvency law applied then the defence would also apply.

Option 3: Amend section 47(2) so a court may treat a settlement agreement as void

31.94 Section 47(2) could be amended so a court may set aside a settlement agreement (in whole or in part) that has the effect of defeating creditors. The purpose of giving a court discretion would be to protect agreements if, for example:

- (a) the agreement conferred benefits on creditors even if those benefits did not equate to the actual value of the property the debtor partner relinquished under the agreement; or
- (b) the non-debtor partner (or the partners' children) would suffer hardship or injustice if the agreement was defeated.

⁹² Insolvency Act 2006, s 208.

31.95 Section 47(3) would then be removed because protection for partners would be exercised through the court's discretion under section 47(2).

Option 4: Increase the protected interest when the partners have separated

31.96 When determining whether an agreement has had the effect of defeating creditors for the purposes of section 47(2), section 20A is important. Section 20A provides that creditors' rights continue as if the PRA had not been enacted. If a partner transfers his or her property to the other partner under a settlement agreement, it is no defence to section 47(2) to say the other partner could have that property under the PRA.

31.97 The only exception is a partner's protected interest in the family home.⁹³ The rule in section 20A is subject to the protected interest. That means that an agreement will not have the effect of defeating unsecured creditors (and therefore cannot be void) if it transfers only the value of the other partner's protected interest in the family home.⁹⁴ Likewise, if a partner transfers more of his or her property to the other partner through an agreement, the agreement will only be void under section 47(2) in respect of any amount above the other partner's protected interest.⁹⁵

31.98 One option for reform is to provide partners who have separated with a greater protected interest. This would require amendments to the PRA's provisions regarding the protected interest and amendments to the Property (Relationships) Specified Sum Order 2002.

CONSULTATION QUESTIONS

K10 Which option for reform do you prefer? Why?

K11 Are there viable options for reform that we have not considered?

⁹³ Property (Relationships) Act 1976, s 20A.

⁹⁴ See discussion in *Neill v Official Assignee* [1995] 2 NZLR 318 (CA) at 322–323 per Richardson J.

⁹⁵ The protected interest will, however, only apply in respect of the partners' family home: Property (Relationships) Act 1976, s 20(B). If no home exists, the protected interest may attach to other relationship property: Property (Relationships) Act 1976, ss 20B(1)(a)–20B(1)(c).