CHAPTER 11

Creditors

IN THIS CHAPTER, WE CONSIDER:

how the rights of creditors are affected by the PRA, and whether reform is required in relation to:

- the general policy of the PRA on creditors;
- the protected interest in the family home;
- the procedure for section 42 notices of claim of interest in land;
- the two year period for challenging agreements that defeat creditors' rights (section 47(2)); and
- the effect of partners' settlement agreements on creditors' rights (section 47(3)).

THE GENERAL POLICY OF THE PRA ON CREDITORS

Current law

11.1 As a general rule the PRA does not affect the rights of creditors. This is reflected in the key provisions of section 19 (which preserves each partner's right to deal with their property as if the PRA had not been passed) and section 20A (which provides that the creditors of a partner have the same rights against that partner as if the PRA had not been passed).[639] Generally speaking, the rights of secured creditors take priority over the rights of partners (section 46).

11.2 Sections 19 and 20A apply except as otherwise expressly provided in the PRA. The main exceptions to the general rule relate to the protected interest in the family home, registering notices of claim on land and the provision for agreements that defeat the rights of creditors. These matters are discussed below.

639 We do not discuss the situation in relation to creditors and a deceased partner but note in this context different provisions apply: Property (Relationships) Act 1976, ss 58 and 59; and Insolvency Act 2006, s 389.

Issues

11.3 In the Issues Paper we explored whether creditors' general priority over a partner's rights under the PRA could cause unfairness in some cases, including where one partner has incurred imprudent or purely personal debt for which both partners are liable (Issues Paper at [31.34]–[31.39]). We observed that section 20E (which provides that where a personal debt has been paid from relationship property, the court may order that the other partner receive compensation or a greater share of relationship property) is only an adequate remedy for partners with sufficient relationship or separate property from which to pay compensation. We also observed that lenders' credit practices would likely change if creditors' rights are diminished when partners separate.

Results of consultation

11.4 We received submissions addressing the general policy of the PRA from the New Zealand Law Society (NZLS), the New Zealand Bankers' Association (NZBA), Bank of New Zealand (BNZ), the New Zealand Federation of Business and Professional Women (BPWNZ), Simpson Grierson and five members of the public. No submitter favoured change to the general policy of the PRA on creditors. BPWNZ submitted that if debts are outstanding they should be addressed in the partners' property division and balanced equitably. Some members of the public submitted that a partner should have greater rights when their partner obtains credit using relationship property without their knowledge, although most submitters focused on how this should be addressed through the division of relationship property, rather than whether it should directly affect creditors' rights.

Preferred approach

11.5 We are satisfied that the general policy remains sound for the reasons given in the Issues Paper (Issues Paper at [31.34]–[31.37]). This is endorsed by the submissions received on this issue.

11.6 Some submitters raised the problem where one partner improperly dissipates relationship property, for example by incurring imprudent or purely personal obligations to third party creditors. We think the preferable remedy in such circumstances is to provide relief as between the partners rather than affect the partners' liability to the third party creditor. We will address the dissipation of relationship property by one partner during the relationship in our final report.

11.7 Although we do not recommend any reform of the PRA's general approach to creditors, there are specific issues relating to the protected interest in the family home, notices of a claim of interest in land (section 42) and the provisions for setting aside agreements that defeat creditors' rights (section 47), which we address below. While some of these issues are of a technical nature, others squarely raise the broader issue of the appropriate balance between the rights of a non-debtor partner to salvage something from the relationship property pool and the rights of an unsecured creditor to recover from a debtor partner. Linked to this is a general issue of financial literacy and the need for education to enable New Zealanders to organise their financial affairs appropriately.

THE PROTECTED INTEREST IN THE FAMILY HOME

Current law

11.8 Section 20B provides that each partner has a protected interest in the family home.[640] It is protected in the sense that a partner's interest takes priority over the unsecured debts of the other partner, unless the debt has been incurred jointly by the partners or the debt has been incurred by a partner subsequently declared bankrupt in order to purchase, improve or repair the family home.

11.9 The value of the protected interest is the lesser of the specified sum or half of the partners' equity in the family home. The specified sum is set by regulations under section 53A of the PRA and is currently $103,000.[641]

11.10 The protected interest is also relevant when assessing agreements, dispositions or other transactions between the partners that have the effect of defeating the rights of creditors. Section 47 provides a court with the power to set aside such agreements. Case law has established that an agreement between the partners will not have the effect of defeating creditors' rights if it transfers only the value of the non-debtor partner's protected interest.[642]

11.11 There is considerable overlap between the PRA and the Joint Family Homes Act 1964 (JFHA).[643] The classification of the family home as relationship property under the PRA 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. The Law Commission reviewed the JFHA in 2001 and recommended that it be repealed.[644] While this has not happened, the reasons for this recommendation remain valid (Issues Paper at [31.40]–[31.45]).

11.12 We also observe that section 158 of the Insolvency Act 2006 provides for a bankrupt to retain certain assets. This includes household furniture and effects for the bankrupt and his or her relatives and dependents. This allows the interests of the bankrupt's partner to be taken into account by the Official Assignee in the application of the Insolvency Act.

Issues

11.13 In the Issues Paper we observed that 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 (Issues Paper at [31.46]). We also explained that the drafters of the PRA saw the family home as the principal family asset that would constitute relationship property under the equal sharing regime and thus deserved particular attention (Issues Paper at [31.12]).

---

640 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 the 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.

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

642 *Neill v Official Assignee* [1995] 2 NZLR 318 (CA) at 327.

643 Section 20F of the Property (Relationships) Act 1976 provides that nothing in ss 20–20E derogates from the provisions of the Joint Family Homes Act 1964.

644 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).

11.14 Our preliminary view was that the PRA should continue to provide partners with a protected interest in some form, but we identified several issues with the way the protected interest operates in practice (Issues Paper at [31.47]–[31.63]):

(a) The decreasing rate of home ownership means that the protected interest is not of practical benefit for an increasing number of New Zealanders.[645] The protected interest may be an anomaly in that the PRA confers greater protection on some partners, simply because they invested in a home rather than other types of property.

(b) The specified sum is inadequate and leads to geographic inequalities. It no longer reflects a sum which would provide the equity required for a house of a reasonable minimum standard across New Zealand.[646]

(c) The family home may often be mortgaged and little or no equity may be available to provide a protected interest against unsecured creditors.

11.15 There are two further issues which were not addressed in the Issues Paper, which we discuss below.

How should the protected interest work when equal sharing does not apply?

11.16 There is an issue with how the protected interest works in cases where the general rule of equal sharing does not apply. Section 20B(3) sets out the value of the protected interest in cases where sections 11–12 apply. It is silent about how the protected interest applies if division occurs where extraordinary circumstances make equal sharing repugnant to justice (section 13) or in the case of relationships of short duration (sections 14–14A). Case law has established that the protected interest will apply to marriages of short duration, but a partner cannot claim a protected interest which is greater than what they could attain on the division of relationship property under the PRA.[647] While our proposal in Chapter 4: Qualifying relationships to repeal sections 14–14A will resolve this issue for short-term relationships, the issue remains in situations where section 13 applies.

How should the protected interest work when the family home is not relationship property?

11.17 The protected interest assumes that the family home will always be relationship property. However this is not the case when the family home is held on trust.[648] It will also no longer be the case when the family home is owned by one partner before the relationship began, or was received by one partner as a gift or inheritance from a third party during the relationship, under our preferred approach to classification outlined in

---

645 While the Property (Relationships) Act 1976 attempts to provide for a protected interest when the partners have no family home (ss 11B, 20B(1)(b) and 20B(3)), these provisions are very unlikely to apply when creditors claim against the partners' relationship property, for the reasons discussed in the Issues Paper: Law Commission *Dividing Relationship Property – Time for Change? Te mātatoha rawa tokorau – Kua eke te wā?* (NZLC IP41, 2017) at [31.48]–[31.50].

646 Case law under the Joint Family Homes Act 1964, on which the protected interest is based, has established that the purpose of the specified sum is to represent the equity required for a house of reasonable minimum standard: *Official Assignee v Lawford* [1984] 2 NZLR 257 (CA) at 265 per Cooke J.

647 *Walsh and NZ Law Society v Powell* (1982) 1 NZFLR 103 (HC) at 110. See also RL Fisher (ed) *Fisher on Matrimonial and Relationship Property* (online looseleaf ed, LexisNexis) at [9.9]. Fisher also explains at [9.2] that it is uncertain whether the protected interest would apply to de facto relationships of short duration.

648 The 2015 Household Economic Survey found that 12 per cent of all New Zealand households held their home on trust: Statistics New Zealand *Household Net Worth Statistics: Year ended June 2015* (June 2016) at 9 and 11, cited in Law Commission *Relationships and Families in Contemporary New Zealand – He hononga tangata, he hononga whānau i Aotearoa o nāianei* (NZLC SP22, 2017) at 48.

Chapter 2. When one of these situations applies the family home will remain the owning partner's separate property, except that any increase in value occurring during the relationship will be relationship property. As noted, a partner's protected interest could not exceed their entitlement under the PRA. This means there will be more relationships where no or little value in the family home would be available to a partner to support a protected interest.

Results of consultation

11.18 There was general support from submitters for the PRA continuing to provide a protected interest that takes priority over the other partner's unsecured creditors. We note, however, that the Issues Paper did not include details of our preferred approach to classification and that this will likely further decrease the practical benefits of the protected interest. Nor did the Issues Paper outline possible options for reforming the protected interest.

11.19 NZLS agreed that it is potentially anomalous that the protected interest confers greater protection on those who have invested in a home rather than other types of property and that there is no clear reason why the protected interest should be limited to one particular asset. NZLS noted that many people have an increasingly diverse spread of assets (for example, KiwiSaver entitlements now make up a significant and growing proportion of the relationship property pool). NZLS also acknowledged that a protected interest over a global pool of relationship property may prove unwieldy and less easy to identify than the extent of a partner's interest in a family home. NZBA supported the application of protected interests to relationship property generally but only if there is no family home. NZBA also favoured giving the court or the Official Assignee the ability to overturn a protected interest where there is deliberate action to defeat the rights of unsecured creditors. NZBA observed that if the definition of relationship property is amended to focus on fruits of the relationship, creditors would need appropriate guidance about what is meant by "acquired during or as a result of the relationship". One member of the public submitted that only the home should be subject to the protected interest while two others submitted that all relationship property should be subject to the protected interest.

11.20 NZLS submitted that the protected interest should be set at a level that better reflects the purpose of facilitating home ownership after the end of a relationship. It said there should be further examination of whether the intention is to ensure there is money available for the affected partner to find alternative accommodation or to provide a resource pool that ensures that one partner is protected against the other partner's unsecured debts. NZLS agreed that there are insurmountable problems in fixing a sum or a percentage that is principled and fair across the country. It suggested considering an alternative methodology that identifies the maximum sum that can be granted to a partner, depending on the nature and value of the relationship property pool and the circumstances affecting the specific relationship.

11.21 A number of practitioners submitted that the amount of the protected interest should be raised. One member of the public submitted that the protected interest should be half the equity in the family home, or up to the average house price in the city or region. Other members of the public proposed different sums, one suggesting $1 million and another $250,000. An academic expert observed that the specified sum needed to be revisited and inflation-adjusted.

11.22 The Insolvency and Trustee Service (Official Assignee)[649] supported the existence of a protected interest in the family home but observed that in its experience, the protected interest rarely applied. This might be because the home was held by the partners as tenants in common, was held in trust, or due to the mortgage obligations, no equity was available.

Options for reform

11.23 While we did not address possible options for reform in the Issues Paper, we have given consideration to the following options:

(a) amending the protected interest provisions, by:

(i) extending the protected interest to all relationship property, or to specified items of relationship property; and/or

(ii) changing how the amount of the protected interest is calculated; or

(b) removing the protected interest provisions from the PRA, with a view to consolidating the rights of a non-debtor partner in the insolvency regime.

Preferred approach

P67 The Government should undertake further policy work that considers the options for amending or repealing the protected interest provisions within a broader investigation into the relationship between the insolvency regime and the interests of partners under the PRA. Such an investigation should also:

a. reach a concluded policy decision on the availability of retirement savings to creditors in bankruptcy;

b. consider whether to give greater rights to bankrupts and their families over unsecured creditors in the Insolvency Act 2006; and

c. progress the repeal of the Joint Family Homes Act 1964.

11.24 Our preferred approach is to acknowledge the inadequacies of the current protected interest provisions and for further policy work to be undertaken.

11.25 We have reached this view having regard to the limited availability of the protected interest in practical terms (see paragraph 11.14 above), its failure now to fulfil its original purpose[650] and the difficulties in addressing these issues through amendment of the protected interest provisions, as we explain below.

Problems with extending the protected interest to all relationship property or to specified items of relationship property

11.26 Extending the protected interest to all relationship property or to specified items of relationship property presents a number of problems.

649 The Insolvency and Trustee service is a business unit of the Ministry of Business, Innovation and Employment. It is appointed as the Official Assignee under the State Sector Act 1988 to administer the Insolvency Act 2006, the insolvency provisions of the Companies Act 1993 and the Criminal Proceeds (Recovery) Act 2009.

650 The initial premise of the protected interest as provided for in the Property (Relationships) Act 1976 reflects outdated thinking that focuses unduly on the family home. See discussion in Law Commission *The Future of the Joint Family Homes Act* (NZLC PP44, 2001) at [4], [13] and [14].

11.27 If the protected interest were extended to specified items of relationship property other than the family home, the assets would need to be assets that are common to most relationships and of sufficient value to provide a meaningful protected interest. The debtor partner's retirement savings, such as KiwiSaver entitlements, might be the most obvious assets.[651] However under the current law KiwiSaver entitlements are not available to the creditors of a KiwiSaver scheme member in their bankruptcy.[652] So there may be little utility in extending the protected interest to assets that are already safe from the claims of creditors. Furthermore, the Ministry of Business, Innovation and Employment is currently considering the policy around the accessibility of retirement savings in bankruptcy for the repayment of creditors.[653] Until this review is complete, it is difficult to make any recommendations around extending the protected interest to retirement savings.

11.28 Extending the protected interest to a wider category of relationship property would create considerable complexities for creditors when taking steps to enforce a debt against a partner's property. It would be difficult to determine whether the property in question was relationship property or not. It could also be difficult to determine the extent of the protected interest, depending on how it is to be calculated (see discussion below). The creditor or partner, depending on where the onus would sit, would likely need to undertake the full PRA division process of classification, valuation and determination of the partners' respective shares in the relationship property.

11.29 This approach would be simpler where a partner is adjudicated bankrupt as the Official Assignee will administer all the bankrupt's property. After secured debts are paid out to creditors, the non-bankrupt partner could be given priority ahead of unsecured creditors (other than in respect of joint debts or relationship debts), up to the value of the protected interest. Nonetheless, the Official Assignee would still need to assess the extent of the partners' relationship property, its value and the shares in which the relationship property should be divided. This is likely to increase the costs of administration of bankruptcy.

11.30 This approach could theoretically be enhanced if the partners had the ability to register notice that they claimed an interest under the PRA in items of relationship property other than land, which is currently provided for under section 42 (see discussion below). For example, the Personal Property Securities Act 1999 could be amended so that a partner could lodge a notice in the Personal Properties Security Register (PPSR). This would give notice that a partner claimed an interest in the property under the PRA. It could be removed through similar procedures to challenges to section 42 notices of claim. There would also be similarities to the registration process under the JFHA. A registration scheme could give greater clarity to creditors as to whether or not an item of property would be subject to the non-debtor partner's protected interest. We are aware that British Columbia and Alberta provide partners with a similar ability to register notices

651 Family chattels would be common to most relationships but in many cases would not provide sufficient value, particularly when divided under an equal sharing approach. Family chattels are also essential to day to day living and it does not seem appropriate that they should be used for this purpose. See also Property (Relationships) Act 1976, s 45.

652 *Trustees Executors Ltd v Official Assignee* [2015] NZCA 118, [2015] 3 NZLR 224. See also KiwiSaver Act 2006, s 127.

653 The Ministry of Business, Innovation and Employment published a discussion document in 2016, and we understand their consideration of this issue is ongoing, although there have been no further developments since consultation closed. See Ministry of Business, Innovation & Employment *Discussion Document: Accessibility of retirement savings in bankruptcy for the repayment of creditors* (July 2016).

over personal property.[654] However, establishing a registration scheme would be a significant and costly exercise. We are not persuaded at this stage that a notice regime would be used by partners.[655] Its introduction would also impose a further level of complexity for creditors which may decrease the availability of credit and increase the cost of accessing it.

Problems with changing how the amount of the protected interest is calculated

11.31 Regardless of what property the protected interest should apply to, the amount of the protected interest requires reform, given the issues identified at paragraph 11.14(b) above.

11.32 We have not however been able to identify a principled and fair means by which to update the specified sum, if it is to remain connected to buying a house of a reasonable minimum standard. Regional variations in house prices mean it is difficult to identify how a specified sum could be achieved in a way that is fair on a nationwide basis.

11.33 Basing the specified sum on a percentage of the net value of a property has also been criticised as it disproportionately rewards those who spend more on a family home than those who do not.[656] The choice of percentage would be arbitrary. There is no apparent logic in choosing say 25 per cent over say 10 per cent as a measure of the balance of fairness between a partner and a creditor. Perceptions of fairness might be affected by individual circumstances, such as where a partner had considerable separate property not affected by creditors' claims.

11.34 While it would be possible to set an arbitrary specified sum which does not have any link to buying a house, we do not think this is appropriate given that partners will find themselves in such a variety of financial situations. We note that the two members of the public who did submit on this issue suggested drastically different sums ($250,000 and $1 million).

11.35 It would, however, be possible to specify a percentage proportion of some or all relationship property which could be protected from creditors rather than linking the protected interest to just the home. This would be more responsive to the variety of property the partners may own. If this approach was to be taken we think there would be no need for a specified sum. Nonetheless, identifying an appropriate percentage figure is another potentially arbitrary exercise.

11.36 Alternatively, one approach would be to create a protected interest in say 25 per cent of the net value of some or all relationship property, on the basis that this might be said to appropriately reflect the risk the partner should bear (noting that the PRA has other provisions to respond to dissipation of relationship property by a partner) and the risk an unsecured creditor should bear.

11.37 For the reasons given at paragraph 11.29 above, calculating the protected interest as a percentage of some or all of the relationship property would be easier if the partner was adjudicated bankrupt, although the Official Assignee would still need to identify, classify

654 Matrimonial Property Act RSA 2000 c M-8, s 22; and Family Law Act SBC 2011 c 25, s 99.

655 We note, for example, that the Borrin Survey identified that only 7 per cent of respondents had made a contracting out agreement that was certified by a lawyer: I Binnie and others *Relationship Property Division in New Zealand: Public Attitudes and Values – A general population survey* (Michael and Suzanne Borrin Foundation, Technical research report, October 2018) at [211].

656 Law Commission *The Future of the Joint Family Homes Act* (NZLC R77, 2001) at [15] (footnote 13).

and value the relationship property and determine the partners' respective shares in order to apply the protected interest.

Further policy work is required

11.38 Despite our concern about how the current regime is functioning, and the problems identified with the different options for reform, there may continue to be a place for the concept of a protected interest under the PRA. It may be that a protected interest calculated as a percentage of defined relationship property is the best way forward. We recognise the Law Commission's earlier concern about using a percentage of the net value of the home.[657] But we suggest that relating the percentage to the net equity in defined relationship property which could include retirement savings would be possible while minimising these concerns.[658] It may be that such a protected interest should only be available when the debtor partner has been adjudicated bankrupt. This would mean the Official Assignee would be in control of the bankrupt's property and would promote an orderly dealing with the interests of the non-debtor partner and the unsecured creditors.

11.39 Alternatively there may be potential for the Insolvency Act to better respond to the interests of non-debtor partners where their partner has been adjudicated bankrupt. Section 158 of the Insolvency Act already provides for a bankrupt to retain certain assets. This includes household furniture and effects for the bankrupt and his or her relatives and dependents. The protected interest could be removed from the PRA and section 158 of the Insolvency Act amended so that other assets (or a proportion of them) are retained for the bankrupt or the bankrupt's partner or family in preference to unsecured creditors.[659] This would provide the benefit against unsecured creditors to all individuals and would not be premised on them being in a relationship. However, the broad question of the appropriate balance of interests between a bankrupt and his or her family, and creditors, is not within the terms of our review so these questions would require separate investigation.

11.40 There are also important choices to be made about the availability of retirement savings to creditors in bankruptcy. These matters fall outside our terms of reference but deserve attention.

11.41 This broader policy work should also consider the ongoing role of the JFHA. While the JFHA remains law, partners are able to register their house as a joint family home and obtain the protections offered by that Act (although the specified sum under that Act is subject to the same criticisms made earlier in relation to the specified sum under the PRA). While the status of the JFHA is not within the terms of our review, we think that the Law Commission's 2001 recommendation to repeal the JFHA remains valid.[660]

---

657 Law Commission *The Future of the Joint Family Homes Act* (NZLC R77, 2001) at [15] (footnote 13).

658 Given the relative illiquidity of retirement savings there will not be the same opportunity for gaming as the Law Commission identified with a house.

659 The Law Commission proposed something similar in its discussion document about the Joint Family Homes Act 1964: Law Commission *The Future of the Joint Family Homes Act* (NZLC PP44, 2001) at [45]. The Law Commission rejected a blanket protection for homes in its report on the Join Family Homes Act 1964: Law Commission *The Future of the Joint Family Homes Act* (NZLC R77, 2001) at [16]–[18].

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

11.42 There is a need for the Government to undertake further policy work in this area. Our review has identified significant problems with the operation of the protected interest provisions. But there are no simple amendments that would address the issues. In light of this, there is a strong argument for removing the protected interest provisions from the PRA. But a final decision on amendment or repeal needs to be considered within the broader context of the relationship between the insolvency regime and the interests of partners under the PRA, which is beyond the scope of this review.

SECTION 42 NOTICES OF CLAIM OVER LAND

Current law

11.43 Section 42 allows a partner with a claim or interest in land under the PRA to register a notice on the title of the land. Section 42(5) provides that a notice can be registered even though no PRA proceedings are pending or in contemplation. The effect of a notice has been described as a "stop sign" because once registered it prevents dealings with land.[661] Once lodged, notices of claim can only be removed by order of the Family Court, District Court or High Court (section 42(3)). A notice of claim will be removed if a court is satisfied that the claimed interest is unsustainable or suspicious or the notice has done its work.[662]

11.44 Section 42 is significant because it allows a partner to register a notice at any point in the relationship, despite the rule that partners' rights under the PRA are deferred until they separate and their property is divided. In this way, it alters the general position under the PRA that the claims of a partner do not affect the rights of third parties and creditors.

Issues

11.45 We discussed the section 42 notice of claim procedure in the Issues Paper (at [31.64]–[31.66] and [14.84]–[14.94]). We observed that the notice of claim procedure was widely used, which suggests that many people find it a useful mechanism.

11.46 We noted that concerns had been expressed about the form prescribed for section 42 notices because the form does not clearly contemplate the possibility that the parties may have separated or that one of them has died.[663]

11.47 We also observed that section 42 may be seen as another example of the PRA giving special protection to the family home, in circumstances where rates of home ownership in New Zealand are decreasing. However, a section 42 notice of claim may be used in relation to any land, not just the family home, and so is more broadly available.

11.48 We noted that it is uncertain how the notice of claim procedure applies to certain types of property, including property legally owned by a third party, such as a company of trustee.

---

661 *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 registerable 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.

662 See *Gregan v Gregan* [1983] NZLR (CA); *Laing v Laing* (1988) 4 NZFLR 629 (HC); *Doyle v Doyle (No 2)* [2004] NZFLR 43 (CA); *Mulholland v Tonar* HC Auckland CIV-2005-404-6870, 30 March 2006; and *C v C* FC Auckland FAM-2009-004-1390, 8 September 2009.

663 Nicola Peart (ed) *Brookers Family Law — Family Property* (online looseleaf ed, Thomson Reuters) at [PR42.05].

Results of consultation

11.49 Submitters supported the PRA continuing to provide partners with the ability to lodge notices of claim in respect of land in which they assert an interest.

11.50 NZLS submitted that the section 42 notice of claim procedure remains relevant as a means to preserve property that will form part of a relationship property claim. NZLS observed that this is particularly critical for a partner potentially affected by dealings with relationship property where that partner has no control over the property in question. That the right can be exercised quickly and at a relatively low cost also makes the right accessible from a practical perspective. NZLS regards section 42 as a reasonable exception to the general principle concerning creditors' rights, noting that public registers are at the heart of credit-related activities and it is not unduly onerous to expect a creditor to monitor relevant public registers, recognise when a notice of claim has been lodged, and take action as necessary to preserve its position.

11.51 NZBA expressed concern about situations where a partner registers a baseless claim. NZBA thought the process for challenging a notice of claim should be simplified thereby reducing the cost of removal, helping to minimise the erosion of equity on the property. Alternatively, NZBA suggested that a partner provide evidence to support a notice of claim. NZBA did not provide detailed proposals for such changes. BNZ generally supported NZBA's submission.

Preferred approach

11.52 No reform is required to the section 42 notice of claim procedure.

CHALLENGING AGREEMENTS THAT HAVE THE EFFECT OF DEFEATING CREDITORS' RIGHTS

Current law

11.53 Section 47(2) provides that an agreement or disposition between partners that has the effect of defeating creditors' interests (but was not intended to do so) "is void against such creditors and the Official Assignee during the period of two years after it is made".

11.54 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.[664] Creditors must therefore challenge an agreement within a two year period after the agreement is made if the agreement is to be void against affected creditors.

Issues

11.55 In the Issues Paper we noted that interpreting section 47(2) as imposing a two year limitation period may disadvantage creditors and the Official Assignee (Issues Paper at [31.67]–[37.72]). Specifically:

(a) Many creditors will be unaware that partners have entered an agreement until after the two year limitation period has expired, or they may not have been creditors when the relevant agreement was made. Involuntary creditors must first obtain

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

judgment against the partner or partners, which may take months if not years. The partners may also conceal their agreement.

(b) Section 47(2) is different to the position under general insolvency law, which is arguably more favourable to creditors. Sections 194 and 195 of the Insolvency Act 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 the two years immediately before the person who made the transaction was adjudicated bankrupt. As a result, affected creditors may 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. We noted however that there may be good reasons to limit creditors' rights to set aside partners' agreements. Partners will want confidence that the agreements they reach with one another can be relied upon. There may be situations where a partner's rights to relationship property are more deserving than those of unsecured creditors.

11.56 The Supreme Court in *Felton v Johnson* was also uncertain how the limitation period would apply to the Official Assignee (Issues Paper at [31.73]–[31.75]).[665] 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.[666] The Court considered that the Official Assignee's position was a "matter of considerable difficulty".[667] It was unclear whether section 47(2) simply required 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).[668] It is also uncertain whether and to what extent a claim by the Official Assignee displaces the claims of individual creditors.[669]

11.57 The Supreme Court concluded its judgment in *Felton v Johnson* by recommending legislative attention to section 47. We agree that this is appropriate.

Options for reform

11.58 In the Issues Paper we presented two options for reform (Issues Paper at [31.76]–[31.81]):

(a) **Option 1**: Remove section 47 from the PRA and rely on the general law of insolvency.[670] 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.

(b) **Option 2**: Amend section 47(2). We identified several possible amendments that could be made, including amendments so that:

(i) the meaning of the two year period is made explicit;

(ii) the steps the Official Assignee must take to challenge an agreement are set out; and

665 At [24].

666 At [21].

667 At [24].

668 At [24].

669 At [24]. See also *Official Assignee of X (Bankrupt) v Y* [2017] NZHC 1117, [2017] NZFLR 320.

670 Elizabeth Tobeck "Relationship property and creditors" [2006] NZLJ 413 at 414–416.

(iii) if the Official Assignee intervenes, the effect that would have on the position of other creditors is clarified.

Results of consultation

11.59 NZLS submitted that partners should be able to achieve certainty in managing their PRA matters and supported amending section 47(2). NZLS preferred Option 2, and harmonising section 47(2) with the Insolvency Act, by providing that an agreement or transaction could be challenged if it is made within the two year period prior to a partner's bankruptcy. NZLS submitted that the amended provision should be expressed in simple terms to enhance its accessibility. The Official Assignee agreed that the two year period referred to in section 47(2) was problematic and if interpreted as a limitation period could mean that the Official Assignee did not have enough time to act once appointed to commence proceedings. The Official Assignee favoured harmonising the PRA's provisions with the Insolvency Act, in particular the voidable preference provisions, and also having the High Court deal with such issues. NZBA considered that the two year limitation period provided by section 47(2) is difficult for creditors as often they will not know an agreement exists and the consequences of such an agreement may only become apparent after the two year period has passed. NZBA preferred Option 2, and considered the two year period too short. BNZ generally supported NZBA's submission. One practitioner considered that the two year, no knowledge, limitation period in section 47(2) was anomalous. An academic considered that it was a concern that creditors did not know "that or when" the transaction between the parties occurred.

Preferred approach

P68 The PRA should clarify that a creditor may only challenge an agreement, disposition or other transaction between the partners that has the effect of defeating the rights of creditors as void within two years of the agreement, disposition or transaction being made.

P69 The Official Assignee should be able to treat an agreement, disposition or other transaction between the partners as an insolvent transaction under the Insolvency Act 2006 if it:

a. enabled a partner to receive more than they would in the other partner's bankruptcy; and

b. was made within the two years immediately before the partner is adjudicated bankrupt.

P70 An application by the Official Assignee to set aside an insolvent transaction should displace any claims by other creditors that an agreement, disposition or other transaction has the effect of defeating creditors' rights.

11.60 Our preferred approach is to clarify the operation of section 47(2) by confirming the Supreme Court's approach in *Felton v Johnson* and addressing how the limitation period applies to the Official Assignee.

11.61 We recognise there is some merit in Option 1. Removing section 47 and relying on the general law of insolvency might be seen as aligning the PRA with the PRA's general position that creditors' rights continue as if the PRA had not been passed. The difficulties with section 47 would cease to exist. The general law of insolvency, however, currently 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. As we concluded earlier, further work on the intersection of the insolvency regime with the interests of partners under the PRA is required. Until that work is undertaken, we prefer Option 2 as it addresses current difficulties in the operation of section 47(2).

11.62 We are not persuaded that the two year period is too short. While there will be situations where creditors are unaware of a transaction between the partners, a longer period would be just as arbitrary. We think that it is desirable that partners have certainty that their resolution of PRA matters will not be overturned after a longer period, given the likelihood they will have moved on with their lives

11.63 We also propose that the Official Assignee be given powers that are broadly in line with the regime for insolvent transactions under the Insolvency Act (see particularly sections 194 and 206). The Official Assignee should be able to treat an agreement, disposition or other transaction between the partners as an insolvent transaction if:

(a) it enabled a partner to receive more than they would in the other partner's bankruptcy (which may require a determination of the solvent partner's protected interest); and

(b) it was made within two years immediately before the partner is adjudicated bankrupt.

11.64 If the transaction between the partners constitutes an insolvent transaction the Official Assignee should be able to apply to the court to cancel the transaction. Any application to set aside an insolvent transaction would displace creditors' claims that an agreement, disposition or other transaction has the effect of defeating creditors' rights. The court may cancel the transaction to the extent that it has enabled the non-bankrupt partner to receive a preference.

11.65 We propose that the Official Assignee should be required to make any application to cancel an insolvent transaction to the High Court, in order to keep issues relating to a bankrupt's estate within the same court and broadly the same procedures. The process concerns a narrow issue under the PRA rather than substantive questions about the division of relationship property so there is less reason to refer the matter to the specialist Family Court.

THE EFFECT OF SETTLEMENT AGREEMENTS ON CREDITORS' RIGHTS

Current law

11.66 Section 47(3) provides that, for the purposes of section 47(2), an agreement made for the purpose of settling the partners' rights under the PRA[671] is "deemed to have been made for valuable consideration".

[671] 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

Issues

11.67 In the Issues Paper we said that the practical effect of section 47(3) was unclear and identified three particular uncertainties (Issues Paper at [31.84]):

(a) Section 21K already provides that all contracting out agreements are "taken to have been for valuable consideration". It is unclear whether section 47(3) means something different.

(b) 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.[672] Section 47(3) may be redundant if it was intended to require creditors to prove the inadequacy of consideration, as creditors already bear that onus under section 47(2).

(c) It is unclear why deeming agreements to be for "valuable consideration" is relevant to section 47(2). Section 47(2) is concerned with whether an agreement was for adequate consideration. An agreement could be for valuable consideration but still defeat creditors.

11.68 In the Issues Paper we discussed whether section 47(3) appropriately balances the rights of separated partners and the interests of unsecured creditors (Issues Paper at [31.85]–[31.89]). We explained that if a partner's property rights under the PRA are based on the contributions they make to a relationship, those contributions have been made regardless of whether the partners have separated or not. We also observed that giving greater rights to separated partners would be a further erosion of the general principle that creditors' rights continue as if the PRA had not been passed.

11.69 We noted that there may be some cases where the partners would not exchange consideration under an agreement that was of exact monetary value, but there may still be good reasons not to set aside the transaction. We said that such bargains should not be lightly overturned because:

(a) a partner may receive advantages that indirectly benefit creditors, such as allowing a partner to retain business assets so their 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;

(c) a partner may accept significant burdens in order to receive a greater share of the property, such as childcare 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.

---

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.

672 This 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.

Options for reform

11.70 In the Issues Paper we suggested several options for reform (Issues Paper at [31.90]–[31.98]):

(a) Option 1: Remove section 47(3) altogether. This reflects a policy position that a partner's rights under a section 21A settlement agreement should not take priority over the rights of the other partner's unsecured creditors. The amendment would be insignificant as it would simply remove a provision with no practical effect.

(b) Option 2: Replace section 47(3) with the defences that exist under general insolvency law. Under the Insolvency Act, a court must not order recovery from a person who receives property if the recipient:[673]

(i) received the property in good faith from the bankrupt;

(ii) did not suspect the person who provided the property was insolvent; and

(iii) gave value for the property or altered their position in the reasonably held belief that the transfer of the property was valid and would not be cancelled.

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

(c) Option 3: Remove section 47(3) and amend section 47(2) so a court may set aside a settlement agreement (in whole or in part) that has the effect of defeating creditors' rights. The purpose of giving a court discretion would be to protect agreements if, for example:

(i) 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

(ii) the non-debtor partner (or the partners' children) would suffer hardship or injustice if the agreement was defeated.

(d) Option 4: Increase the amount of the protected interest (see discussion on the protected interest above).

Results of consultation

11.71 NZLS shared the concern about the apparent arbitrariness of providing partners who have separated with greater rights than those who have not separated. NZLS also agreed that this could undermine the rule in section 20A of the PRA that creditors have the same rights as if the PRA had not been enacted. NZLS concluded that further policy work and consultation was required as to whether a partner's rights under a settlement agreement should take priority over the rights of unsecured creditors for the purposes of section 47(2). Despite not reaching a conclusion on the case for reform, NZLS expressed a preliminary preference for Option 2. NZLS suggested that there may also be scope for alternative dispute resolution/tribunal resolution in "very limited cases" where the claim is of low value or where there is a net debt situation, there are no disputes about the extent of assets or whether the PRA applies, and there are no disclosure issues. NZLS considered that the tribunal procedure would need to include pre-tribunal mandatory

673 Insolvency Act 2006, s 208.

disclosure and access to legal advice funded by legal aid, as well as a right of appeal from any tribunal decision. NZLS suggested one option for reform would be to provide for the Disputes Tribunal to have jurisdiction where there is a net debt situation or where the total quantum of relationship property equity falls within the Tribunal's jurisdiction under section 10 of the Disputes Tribunal Act 1988.

11.72 The Official Assignee observed that it was difficult to understand section 47(3) and that, if the focus is on valuable consideration, the provision misses the point as valuable consideration must be assessed in relation to how creditors have been defeated rather than what the partner has given as consideration. The Official Assignee favoured harmonising the PRA's provisions with the provisions of the Insolvency Act, including having the issue dealt with by the High Court. BNZ submitted that if reform of section 47(3) was recommended, it favoured Option 3 (allowing any protection for partners to be exercised through the court's discretion) as this would be the most equitable proposal for both partners and creditors.

Preferred approach

P71 A court should not be able to order recovery from a partner who receives property under a section 21A agreement if the recipient:

a. received the property in good faith from the other partner;
b. did not suspect the other partner was insolvent; and
c. gave value for the property or altered their position in the reasonably held belief that the transfer of property was valid and would not be cancelled.

11.73 We broadly favour an approach to the relationship between partners' and creditors' rights under the PRA which more closely reflects the general law of insolvency. Accordingly, we prefer Option 2, replacing section 47(3) with the defences available under section 208 of the Insolvency Act.