

# **THE TENSION BETWEEN PRIVATE PROPERTY AND RELATIONSHIP PROPERTY IN RURAL NEW ZEALAND**

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## ***Purpose of paper***

*This paper is in the early stages of development. It deals with my growing concern about the effect our new relationship property legislation may have on the economic viability of farms. While farms are not the only business at risk from the new legislation giving rights to married and unmarried partners on separation and on death, they are uniquely vulnerable because they combine the family, the home and the business in one entity.*

*The ideas and concerns expressed in this paper are preliminary only. My purpose in putting these ideas forward at this time is to obtain some initial comment on the validity of my concerns and to ascertain whether, and if so how, other jurisdictions take into account the consequences of relationship property rights on the economic viability of private enterprise. Has New Zealand gone too far in allowing relationship property rights to override legal title?*

*This paper will start with a very brief description of farming in New Zealand and the changing family structures that many jurisdictions now face. It will then outline the development of matrimonial property legislation in New Zealand in the 20<sup>th</sup> century before explaining the changes to this legislation made in 2001. While there is not much case law as yet, some decisions have already affected farms and these will be explored.*

## **INTRODUCTION**

New Zealand has traditionally been a farming country. Agriculture of one sort or another has been and remains the backbone of the New Zealand economy. It is still a major export earner for New Zealand. Legislation that threatens the rural sector will therefore affect the economy of this country.

### **Farming in New Zealand**

Farming in New Zealand has traditionally been a family business. Husband, wife and children were all expected to contribute in some way to running the farm. In return, they received accommodation, food and a (modest) income from the farm. Daughters commonly married, leaving the farm and ceasing to be the financial responsibility of their parents. Sons, on the other hand, often remained on the farm, working alongside their father. In due course they would either take over the farm from their father or, if the farm

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was not large enough to sustain all of the sons who wanted to farm, they would be assisted by their father to buy their own farm. Father and mother would continue to live on the farm and be sustained by it, but would gradually reduce their involvement in working the farm. That is still largely an accurate description of farming in New Zealand today.

Farms are unique in the several functions they serve. They are a business providing employment and an income for current and future family members, but they are also integral to family life by providing a home for the family. That concept is under threat from changes in family structures and the legislation that governs the division of property when a marriage or de facto relationship ends on separation or death.

### **Changing family structures**

New Zealand's rate of marital breakdown is high. Separation is common nowadays. So is re-partnering, either by remarrying or by entering into a non-marital relationship. New Zealand now recognises three types of intimate relationship: marriage, civil union, and de facto relationships. Marriage is reserved for heterosexual couples.<sup>1</sup> Civil unions and de facto relationships are open to heterosexual as well as same sex couples.<sup>2</sup>

Civil unions were created by the *Civil Union Act 2004* as an alternative to marriage. Both heterosexual and same sex couples may enter into a civil union and it has the same status as a marriage. The formalities and requirements for civil unions are virtually the same as for marriage.<sup>3</sup> They are both monogamous<sup>4</sup> and must be registered under the *Births, Deaths and Marriages Registration Act 1995*.<sup>5</sup> The *Relationships (Statutory References) Act 2005*, the companion statute to the *Civil Union Act*, amended over 100 statutes to give civil union partners the same rights as married spouses. Both the *Civil Union Act* and the *Statutory References Act* came into force on 26 April 2005.

De facto relationships are not registered and have no legal status, but they are recognized for various purposes, such as property rights on separation or death of a partner.<sup>6</sup> They are defined slightly differently in various statutes. For purposes of the new property rights

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<sup>1</sup> Although the *Marriage Act* is phrased in gender neutral language, the Court of Appeal held in *Quilter v Attorney General* [1998] 1 NZLR 523 that the Act did not provide for marriage between same sex couples. The Court did observe that the Act might be in breach of the *New Zealand Bill of Rights Act 1990*. Section 19(1) of that Act provides that everyone has the right to freedom from discrimination on the grounds of discrimination in the *Human Rights Act 1993*. Section 21 *Human Rights Act 1993* prohibits discrimination on grounds of marital status. However, the *New Zealand Bill of Rights Act* is not an entrenched piece of legislation and therefore does not override inconsistent legislation.

<sup>2</sup> For example, *Re Leonard* [1985] 2 NZLR 88 (CA).

<sup>3</sup> See Part 2 of the *Civil Union Act 2004*.

<sup>4</sup> Section 8 *Civil Union Act 2004*. Parties to a marriage may convert to a civil union and vice versa: ss 17 and 18 *Civil Union Act 2004*.

<sup>5</sup> Section 39 *Civil Union Act 2004*.

<sup>6</sup> The *Property (Relationships) Act 1976*, *Administration Act 1969* (intestacy rules) and *Family Protection Act 1955* (family provision after death) give de facto partners virtually the same rights as spouses and civil union partners on separation and death.

on separation and death, effective since 2002, they are defined in the *Property (Relationships) Act 1976*<sup>7</sup> as two persons, whether of the same sex or the opposite sex, living together as a couple without being married to or in a civil union with each other.<sup>8</sup> The *Property (Relationships) Act* provides a list of factors to assist the court in determining whether two people were living together as a couple.<sup>9</sup> They include sharing a common residence, caring for children, financial interdependence, sexual intercourse, mutual commitment to a shared life and public reputation. None of the listed factors is essential. However, the courts have generally treated the mutual commitment to a shared life as a key ingredient of a de facto relationship.

As part of the legislature's aim to remove all discrimination based on marital status, these relationships are now accorded substantially identical property rights when the relationship ends on separation or on death of one of the parties. These property rights threaten the traditional intergenerational transfer of wealth and the economic viability of farms.

### **Matrimonial Property Rights in New Zealand before 2002**

Between 1884, when the *Married Women's Property Act* was adopted,<sup>10</sup> and 1963, when the first *Matrimonial Property Act* was enacted, New Zealand had a system of separate property. Each spouse retained any assets that he or she acquired before or during the marriage. Marriage did not give spouses any entitlement to share in each other's property.

#### *Matrimonial Property Act 1963*

The *Matrimonial Property Act 1963* was the first legislative attempt to introduce a concept of matrimonial property that could override legal title. The court was given a discretion to award the applicant spouse a share of the defendant spouse's assets based on the applicant's contributions to the defendant's assets.<sup>11</sup> By requiring evidence of contributions to each asset in respect of which a claim was made<sup>12</sup> and by undervaluing domestic contributions, awards in favour of wives were generally confined to the home and commonly did not exceed 30%. Wives could seldom show contributions to the husband's business assets.

When the wife's claim related to her husband's farm, her husband's labour was inevitably valued more highly than hers, even if she had performed the work of a full time farm

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<sup>7</sup> This Act is the renamed *Matrimonial Property Act 1976* to reflect the inclusion of de facto partners in that Act following extensive amendment in 2001.

<sup>8</sup> Section 2D *Property (Relationships) Act*. Section 2 *Administration Act* and s 2 *Family Protection Act* define de facto relationship by referring to the *Property (Relationships) Act* definition.

<sup>9</sup> Section 2D(2) *Property (Relationships) Act*.

<sup>10</sup> The *Married Women's Property Act 1884* gave married women the right to acquire, hold and dispose of property as if they were a feme sole.

<sup>11</sup> S 5 and 6 *Matrimonial Property Act 1963*.

<sup>12</sup> *E v E* [1971] NZLR 859 (CA).

labourer.<sup>13</sup> Furthermore, the farm was often acquired through the husband's family and thus treated as having been contributed by the husband.

### *Matrimonial Property Act 1976*

The courts' failure to appreciate that a woman's domestic contributions enabled the husband to earn an income and build up his assets prompted the legislature to introduce a new statute where the focus was on contributions to the relationship rather than the property. The *Matrimonial Property Act 1976* viewed marriage as a partnership to which each spouse contributed equally albeit in different ways. Each was therefore entitled to share equally in the matrimonial property,<sup>14</sup> unless the parties had formally agreed otherwise.<sup>15</sup> However, this enlightened view of marriage could only be invoked on separation. The old 1963 Act continued to apply if the marriage ended on the death of a spouse.

The 1976 Act defined matrimonial property exhaustively.<sup>16</sup> It included the family home and family chattels whenever they were acquired, property owned jointly or as tenants in common in equal shares, and assets acquired during the marriage. Pre-marital assets were separate property of the owning spouse and not subject to the equal sharing regime unless they were acquired in contemplation of the marriage for the common use and common benefit of both spouses. Increases in the value of separate property could become relationship property if the increase in value was the result of the application of relationship property or direct contributions by the non-owning spouse. Property transferred to a trust ceased to be matrimonial property, and any beneficial interest acquired from the trust during the marriage by either of the spouses was generally protected as the separate property of that spouse.<sup>17</sup> Gifts and inheritances from third parties were similarly protected as separate property of the recipient spouse.<sup>18</sup> The 1976 Act recognised that such acquisitions were not the result of the joint efforts of the spouses.

In regard to the division of matrimonial property between the spouses, the Act drew a distinction between domestic property and other matrimonial property. Provided the

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<sup>13</sup> This niggardly approach continued even after the 1963 Act was repealed in 1976 for marriages ending on separation. It applied thereafter only on death of a spouse. *Re Mora* (Unreported, High Court Christchurch, M160/84, 11 July 1985, Holland, J) decided in the mid eighties gives a taste of the court's conservative approach. There the Court awarded the widow 25% of the farm in spite of finding that for the 26 years of her marriage she had made major domestic contributions and saved her husband the cost of a farm labourer. She was described as the hardest working farming wife in the district, but that did not warrant an equal share of the farm. The Court of Appeal increased the award to 40%, and would have given her 50% but for the fact that the husband acquired the farm from his parents at a reduced price. This case marked a turning point in regard to claims under the 1963 Act for marriages ending on death.

<sup>14</sup> Section 11 *Matrimonial Property Act 1976*.

<sup>15</sup> Section 21 *Matrimonial Property Act 1976*.

<sup>16</sup> Sections 8 to 10 *Matrimonial Property Act 1976*.

<sup>17</sup> Unless the interest had become so intermingled with relationship property with the consent of the recipient owner that it was impracticable to treat it as separate property: s 10 *Matrimonial Property Act 1976*.

<sup>18</sup> Section 10 *Matrimonial Property Act 1976*.

marriage was of at least three years duration,<sup>19</sup> the matrimonial home and family chattels were equally shared<sup>20</sup> unless there were extraordinary circumstances making equal sharing repugnant to justice.<sup>21</sup> This was, and still is, a notoriously difficult exception to satisfy. Domestic property was therefore almost invariably equally shared, but that was not the case with the rest of the matrimonial property. It was easier to rebut the presumption of equal sharing in regard to the balance of matrimonial property by proving that one party's contribution to the marriage partnership had been disproportionately greater than the other spouse's contribution.<sup>22</sup> This exception was commonly invoked successfully in relation to farms. The homestead was separated out and shared equally,<sup>23</sup> while the business side of the farm was often shared unequally, thus preserving its economic viability.

Farms were nonetheless vulnerable to matrimonial property claims and many owners sought to protect their farms by putting them into trust. That removed the farm from the matrimonial property pool and generally put it beyond the reach of the courts' jurisdiction under the *Matrimonial Property Act*. By making the spouses merely discretionary beneficiaries of the trust, it was simple to lock out one of the spouses after separation, thus safeguarding the farm for the remaining beneficiaries, commonly the husband and children. The court did have a discretion under the *Family Proceedings Act 1980* to invade the trust for the benefit of a disadvantaged spouse, but that power was seldom invoked in part because it could only be exercised at the time of divorce, not on separation.<sup>24</sup> There was therefore always at least a two year delay.<sup>25</sup>

### **Criticism of the 1976 Act**

Criticism of various aspects of the *Matrimonial Property Act 1976* began in earnest in the late eighties and increased steadily throughout the nineties.<sup>26</sup> A major criticism was that the Act did not apply on death of a spouse. Surviving spouses were still dependent on the discretionary system of the old 1963 Act which gave them no entitlement to, let alone a guarantee of, an equal share of matrimonial property. Widows, in particular, were therefore at a disadvantage as compared to former wives.

Another criticism was that the Act applied to assets and not to earning capacity. This disadvantaged spouses who had dropped out of the workforce to care for children. On re-

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<sup>19</sup> Section 13 of the *Matrimonial Property Act 1976* allowed that domestic assets could be shared unequally.

<sup>20</sup> Section 11 *Matrimonial Property Act 1976*.

<sup>21</sup> Section 14 *Matrimonial Property Act 1976*.

<sup>22</sup> Section 15 *Matrimonial Property Act 1976*.

<sup>23</sup> Section 12 *Matrimonial Property Act 1976*.

<sup>24</sup> Section 182 *Family Proceedings Act 1980*. *Chrystall v Chrystall* [1993] NZFLR 772 is an example of the Court ordering trustees of a trust settled on the spouses and their children to acquire a home for the former wife and pay her a capital sum, because there was no matrimonial property to share. The farm that the couple had worked on throughout their marriage was held in trust.

<sup>25</sup> Section 39 *Family Proceedings Act 1980*.

<sup>26</sup> See for example, New Zealand Ministry of Justice, *Report of Working Group in Matrimonial Property and Family Protection* (1988); Atkin, Austin and Grainer (eds) *Family Property – Law and Policy* (1995).

entry to the workforce they would be well behind where they might have been but for the division of functions within the marriage.

The Act's inability to access assets that had been transferred to trusts or companies was also criticised. So was the limited scope for converting the increase in the value of separate property into relationship property by requiring direct contributions by the non-owning spouse. Criticism was also levelled at the judiciary for too often dividing the balance of matrimonial property unequally.

As will be immediately apparent, these criticisms related predominantly to the effect the Act was having on women. Although the aim of the *Matrimonial Property Act 1976* was to treat spouses equally and give them an equal share in their matrimonial property, there were several avenues within and beyond the Act that conspired to thwart that aim.

A further concern related to the position of de facto partners. During the 1990s it became increasingly clear that de facto relationships could no longer be ignored. The courts had been sympathetic to the plight of non-owning de facto partners by utilising its equitable jurisdiction to impose constructive trusts where the partners had a reasonable expectation that the assets in dispute would be shared.<sup>27</sup> However, the limits of that equitable jurisdiction and the uncertainty of the claimant's entitlement required reform.<sup>28</sup>

These concerns and criticisms were addressed in 2001 when the *Property (Relationships) Amendment Act* was adopted. The changes made by that Act pose significant challenges to the traditional values inherent in the rural sector and to the property structures commonly utilised to protect farms from claims.

## **PROPERTY (RELATIONSHIPS) AMENDMENT ACT**

The *Property (Relationships) Amendment Act 2001* (the PRA) amends the *Matrimonial Property Act 1976*. While it retains the essential feature of equally sharing relationship assets, it makes several major changes.

### *Increased range of relationships*

First, the Act now applies to marriages, de facto relationships and, since 26 April 2005, to civil unions. Marriages and civil unions are treated in exactly the same way and are subject to the Act's regime from the moment of solemnisation. De facto partners have virtually the same rights as spouses and civil union partners, but they are generally covered by the Act only after they have lived together as a couple for three or more

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<sup>27</sup> *Gillies v Keogh* [1989] 2 NZLR 327 (CA) and *Lankow v Rose* [1995] 1 NZLR 277 (CA) are the leading cases on this jurisdiction.

<sup>28</sup> New Zealand Ministry of Justice, *Report of Working Group in Matrimonial Property and Family Protection* (1988) Part III.

years.<sup>29</sup> As the Act now applies to married as well as unmarried partners, it was renamed the *Property (Relationships) Act 1976*.

*Application on separation and death*

The second major change is that the PRA applies to relationships ending on separation and on death. The new death provisions in Part 8 of the Act were outlined in my paper for the 2004 Australasian Property Law Teachers Conference and will not be discussed further in this paper.<sup>30</sup>

*Domestic and balance relationship property removed*

The third major change is that the distinction between domestic assets and balance of relationship property has been removed.<sup>31</sup> If the parties have not formally contracted out of the Act (see below), *all* relationship property will be equally shared unless the relationship was one of short duration (less than 3 years),<sup>32</sup> or there were extraordinary circumstances that make equal sharing repugnant to justice.<sup>33</sup> This is one of the changes that will affect farms that are still owned by a spouse or partner. The business part of the farm will be equally shared unless it was acquired by gift or inheritance from a third party or as a beneficiary of a trust settled by a third party, such as a parent.<sup>34</sup> Not surprisingly, this change is encouraging more farmers to put their farms into trust.

*Economic disparity provisions*

The fourth significant change was aimed at redressing the economic disparity between the parties after the relationship had ended resulting from the division of functions within the relationship. Sections 15 and 15A give the court the discretion to compensate a spouse or partner whose future income and living standards are substantially lower than the other spouse or partner as a result of the division of functions within the marriage. These provisions are controversial. While the requirements for a compensation order are becoming more settled,<sup>35</sup> assessing the amount of compensation is far from satisfactory and has led to accusations of “judicial plucking”. As the awards are generally modest and unlikely to threaten the viability of a farm, I shall not devote any more attention to these provisions in this paper.

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<sup>29</sup> Sections 4(5) and 14A PRA. The court may make orders under the PRA in favour of a de facto partner of a short duration relationship if there was a child of the relationship or the claimant had made substantial contributions to the relationship, and the court is satisfied that serious injustice would result if no order were made under the Act.

<sup>30</sup> For a detailed explanation and analysis of the Act’s death provisions see NS Peart, M Briggs and RM Henaghan (eds) *Relationship Property on Death* (2004).

<sup>31</sup> It remains only for marriages or civil unions of short duration: ss 14 and 14AA PRA.

<sup>32</sup> Sections 14, 14A and 14AA PRA.

<sup>33</sup> Section 13 PRA.

<sup>34</sup> Section 10 PRA.

<sup>35</sup> *De Malmanche v De Malmanche* [2002] 2 NZLR 838 was the first case to consider ss 15 and 15A and is the leading case on the requirements of those sections.

*Bigger relationship property pool*

Of greater relevance to the topic of this paper are the subtle changes made to some classification provisions that will have the effect of increasing the relationship property pool. Property acquired before the relationship began is generally separate property. Under the old Act such property would be matrimonial property if it was acquired in contemplation of the marriage and then only if it was intended for the common use *and* common benefit of both spouses. The PRA changed the italicised word “and” to “or”.<sup>36</sup> The significance of this change is best appreciated by looking at *Brophy v Brophy*, a case decided under the *Matrimonial Property Act 1976*, where the wife unsuccessfully argued that a herd of cattle acquired shortly before marriage was matrimonial property.<sup>37</sup> Although the cattle had been acquired in contemplation of marriage for the common benefit of both spouses, it was not intended for their common use. The wife did not use the cattle! Under the PRA Mrs Brophy’s argument would have succeeded. The cattle would have been relationship property and she would have shared equally in their value.

A similarly subtle change was made to the provision that converts the increase in value of separate property into relationship property. The *Matrimonial Property Act* required the application of matrimonial property or *direct* actions by the non-owning spouse to the increase in value of the owning spouse’s separate property. The nexus between the non-owning spouse’s actions and the increase in value was difficult to prove, particularly for women. They struggled to show that their domestic contributions were directly referable to the increase in value of their husband’s business assets. The PRA amended this provision by adding indirect actions.<sup>38</sup> The new s 9A has the potential to increase the pool of relationship property significantly, as is already becoming apparent from the following two farming cases.

In *Nation v Nation* the husband purchased half the family farm shortly after his marriage and subsequently acquired the other half as a beneficiary of a family trust.<sup>39</sup> The first half was relationship property, having been purchased during the marriage. The other half was his separate property.<sup>40</sup> When the couple separated after a 28 year marriage, the Court found that the wife’s domestic work and assistance on the farm were causally linked to the increase in value of the farm.<sup>41</sup>

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<sup>36</sup> Section 8(1)(d) PRA.

<sup>37</sup> (1992) 9 FRNZ 468.

<sup>38</sup> Section 9A PRA.

<sup>39</sup> [2005] NZFLR 103 (CA).

<sup>40</sup> Section 10 PRA.

<sup>41</sup> The wife failed to obtain a share of the increase in value, however, because she did not provide a valuation of the property when her husband acquired the second half of the farm from the trust. There was therefore no starting date from which to measure the increase in value. It seems that nobody appreciated that it was not until the trust distributed the half share of the farm to the husband that it became the husband’s property. Prior to that it belonged to the trust of which the husband was merely a discretionary beneficiary. The husband and wife’s actions in respect of that part of the farm were therefore contributions to the trust, not to the husband’s separate property.



The Court came to the same conclusion in *Q v Q* where the husband argued successfully that his gratuitous accountancy services, his income and his labour on the farm contributed to the increase in value of a farm in which his wife held a remainder interest.<sup>42</sup> The farm having increased in value from \$150,000 to \$4 million during their 22 year marriage, the husband was awarded a half share of that increase, thus effectively taking half the farm! Apparently, the parties have since come to a settlement. There were some flaws in the Court's valuation of the wife's interest in the property,<sup>43</sup> but the Court's reasoning in regard to the husband's entitlement in terms of s 9A of the Act was correct. Not surprisingly, this decision sent shock waves around the legal community.

### *Trust and company provisions*

Another significant change that will affect farms is the change directed at dispositions of assets to trusts and companies. Farmers have established trusts and, to a lesser extent, companies to protect their farms from claims by creditors, spouses and partners, as well as from testamentary claims. Trusts and companies were seen as providing security against division of the asset, maintaining the asset as a viable economic entity and providing for future generations.

However, the use of these property structures was criticised, because they generally placed the assets beyond the reach of the Act's sharing regime. A disposition of property by a spouse to a trust or a company could be set aside under s 44 of the *Matrimonial Property Act 1976* only if the disposition was made in order to defeat the rights of one of the parties under that Act.<sup>44</sup> Proving the required intent was very difficult. While it did not have to be the sole purpose of the disposition, it had to be the dominant or true purpose. There had to be 'a conscious desire to remove ... property from the reach of the Courts'.<sup>45</sup> It was usually easy enough to justify the disposition on legitimate creditor protection or estate planning grounds, even if its effect was to defeat the rights of one of the parties to the relationship. Section 44 was therefore of little value to a spouse who would have been entitled to share equally in those assets if they had not been transferred to a trust or a company.

The *Property (Relationships) Amendment Act 2001* introduced new provisions to overcome the difficulties with s 44. The new "trust busting" provision is set out in s 44C. It gives the court the power to order compensation if after the relationship began relationship property has been disposed of to a trust and that disposition has the effect of defeating the rights of one of the parties to the relationship. Section 44F provides a

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<sup>42</sup> (2005) 24 FRNZ 232 (FC).

<sup>43</sup> The Court did not discount for the fact that the wife's remainder interest was contingent on her being alive at distribution in 2028. Nor did the Court take into account the interests of other discretionary beneficiaries.

<sup>44</sup> Section 44 PRA is to the same effect.

<sup>45</sup> *Coles v Coles* (1987) 3 FRNZ 101 (CA).

similar remedy for dispositions of relationship property to companies in which one of the parties holds a controlling interest.<sup>46</sup>

The requirements to satisfy s 44C are:

- a. a disposition
- b. after the relationship began
- c. the disposition must be of relationship property
- d. the disposition is not one to which s 44 applies
- e. the disposition must have the effect of defeating the rights of one of the parties under the Act.

Proving the first four criteria is generally straightforward, although uncertainty about the starting date of a de facto relationship may create some difficulties. The disposition may have occurred before the parties were living together as a couple and thus not be caught by s 44C. Alternatively, the assets transferred into trust may have been acquired before the relationship began and not be relationship property. Section 44C would not apply then either.

The requirement that has caused most difficulty is the last one. The disposition must have the effect of defeating the rights of one of the parties under the Act. After several conflicting decisions, *Nation v Nation* came before the Court of Appeal on this point.<sup>47</sup> As mentioned earlier, Mr Nation owned a farm, half of which he had bought during his marriage and the other half he acquired as a beneficiary of his father's family trust. In 1999, a year before separating from his wife, Mr Nation sold his farm to a trust of which he and his wife were discretionary beneficiaries. The sale price was \$991,813, the market value at the time, and was financed by an interest free loan owing to the husband. The debt was still outstanding when the couple separated a year later. The farm was then worth \$1,375,000 and by the time their relationship property claims came on for hearing in 2002 the farm's value had increased to \$1,725,000.

In terms of the Act, Mrs Nation was entitled to a half share of the couple's relationship property. The wife had few assets and the husband's principal asset was the \$991,813 debt owed by the trust. Half of that debt was relationship property, being the sale proceeds of the half share of the farm that the husband had bought during the marriage. The other half of the debt was his separate property, being the proceeds of the interest he received from his father's trust. That meant that Mrs Nation was entitled to share equally in about \$495,000, while Mr Nation retained the rest of the outstanding debt. Furthermore, it was clear that Mrs Nation would receive no further benefit from the trust, whereas her husband would. So, in an attempt to secure a share of the increase in value of the farm, Mrs Nation made a claim under s 44C.

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<sup>46</sup> A controlling interest means that the spouse or partner holds directly or indirectly equity securities in the company that carry in the aggregate 50% or more of the voting rights at a general meeting of the company: s 44D PRA.

<sup>47</sup> *Nation v Nation* [2005] 3 NZLR 46 (CA).

The sale of the farm was a disposition and half of it was relationship property. The disposition had been made since the marriage began, and there was no evidence that the disposition had been made to defeat Mrs Nation's rights under the PRA. The first four requirements of s 44C were therefore satisfied. That left only the question whether the disposition had the effect of defeating her interests under the Act.

The Court of Appeal decided first that the effect of the disposition had to be assessed at the time when the s 44C application was heard at first instance, rather than at the date of disposition as another Court had decided.<sup>48</sup> Second, the term "defeat" merely required evidence that the relationship property pool had been diminished and, third, the effect of the disposition had to be assessed by looking at all the circumstances. On that basis, the Court concluded that Mrs Nation's rights had been defeated by the sale of the farm to the trust

At the hearing date in 2002 Mrs Nation was entitled to share equally in half the value of the outstanding debt, whereas if the farm had not been transferred into trust, she would have shared in half the value of the farm as at the date of hearing. In other words, she was entitled to \$247,500, being her entitlement in half the value of the debt, whereas if the farm had not been sold to the trust she would have been entitled to \$431,250, being her share of half the value of the farm. The disposition to the trust thus had the effect of reducing the relationship property pool. Furthermore, Mrs Nation's rights under the trust were discretionary and unlikely to provide her with any ongoing benefit after separation. The disposition of the farm to the trust removed relationship property that Mrs Nation would otherwise have shared and thus defeated her rights under the Act. Her interest in the farm had been exchanged for a half share in a static debt, while Mr Nation continued to benefit from the farm as a beneficiary of the trust.

This was precisely the sort of disposition that Parliament had in mind when it enacted s 44C, because it deprived one of the spouses of her relationship property entitlement, while the other continued to enjoy the benefit of the assets transferred to the trust.<sup>49</sup> Mrs Nation's interests under the PRA were prejudiced by that disposition.

Although s 44C has been characterised as a "trust busting" device, the court has no power to "bust" the trust in the sense of removing capital. If the court finds that a disposition meets the requirements of s 44C, then it has a discretion to order the other spouse or partner (Mr Nation) to pay compensation from his share of the relationship property or his separate property. If that would not adequately compensate the spouse or partner claiming under s 44C (Mrs Nation), then the court has the power to order that income from the trust be paid until the amount of compensation it deems appropriate has been paid.<sup>50</sup> While the court may have no power to remove capital from the trust under s 44C, it could indirectly decimate the trust by compelling Mr Nation to call in the debt owed by the trust, forcing a sale of the trust asset. That could be enough to destroy the trust.

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<sup>48</sup> *P v P* [2003] NZFLR 925 (FC).

<sup>49</sup> New Zealand Ministry of Justice, *Report of the Working Group on Matrimonial Property and Family Protection* (1988) pp 29-31.

<sup>50</sup> Section 44(2) and (3) PRA.

Section 44C thus poses a real risk to trust structures where debts to either spouse or partner remain outstanding.

As *Q v Q* and *Nation v Nation* show, both sections 9A and 44C of the PRA can make substantial inroads into the protection that separate property had under the *Matrimonial Property Act*. They are powerful tools in the hands of the non-owning spouse or partner and particularly useful in the context of farms where there is often a close connection between the parties' contributions and the farming business.

### *Contracting out of the PRA*

One of the ways of limiting the impact of the PRA is by contracting out of the Act. Section 21 of the PRA entitles spouses and partners to make any agreement they think fit with respect to the status, ownership and division of their current or future property. The agreement must be made in accordance with prescribed formal requirements, the most important of which is that each party must receive independent legal advice about the effect and implications of the agreement.<sup>51</sup> That means that they must be advised not only about their rights in terms of the agreement, but also what rights under the PRA they are sacrificing.<sup>52</sup> Failure to comply with these formalities renders the agreement void.<sup>53</sup> Even if the agreement complies with the formal requirements, it may still be set aside if enforcing it would cause serious injustice.<sup>54</sup>

Here is another change in the Act. Under the *Matrimonial Property Act 1976*, agreements could be set aside if they were merely unjust. There was widespread criticism that agreements were being set aside too easily. The change to "serious injustice" was in response to that criticism. It was intended to make setting aside agreements more difficult. This was also an important aspect of the justification for including de facto partners in an "opt out" regime rather than an "opt in" regime. Parties who contract out of the PRA after receiving the required advice should be able to rely on the agreement. The case law thus far appears to be giving effect to this aim.<sup>55</sup>

If used appropriately, a contracting out agreement could provide considerable protection for farms. The agreement could safeguard the farm from the equal sharing regime by classifying it as separate property before it is transferred to a trust or a company, thereby foreclosing a claim under s 44C. It would also be possible to rule out claims under s 9A. However, if the agreement is used to prevent a spouse or partner from receiving any share of the assets accumulated during the relationship, the court may well find that the agreement is seriously unjust. The entitlement to share in the fruits of a relationship is so firmly embedded that the courts will go to considerable lengths to ensure that entitlement is satisfied in some way. The PRA has given the courts extra tools with which to achieve

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<sup>51</sup> Section 21F PRA.

<sup>52</sup> *Coxhead v Coxhead* [1993]2 NZLR 397 (CA) set the standard for advice.

<sup>53</sup> Section 21F PRA.

<sup>54</sup> Section 21J PRA.

<sup>55</sup> *Harrison v Harrison* [2005] NZFLR 252 (CA).

that outcome. These new tools pose a significant threat to existing farming structures and render them vulnerable to claims which may undermine their economic viability.

## **DEVELOPMENTS BEYOND THE PRA**

The PRA has created a strong expectation of entitlement for spouses and partners. That expectation is spilling over into other areas of the law, most particularly the law of trusts. New Zealand has one of the highest rates of trust use in the world. It is estimated that one in five New Zealanders are involved in a trust in some way, whether as a settlor, trustee or beneficiary.<sup>56</sup> Trusts are seen as a mechanism for protecting assets from a variety of sources, but the full implications of a trust are often not appreciated by settlors and trustees.<sup>57</sup>

### *Sham and alter ego trusts*

Many settlors continue to treat the assets in trust as if they still own them and fail to observe even the most basic principles of the fiduciary relationship they have created. That is particularly so if they are also a trustee and/or a beneficiary. Not surprisingly, the courts are beginning to look at these trusts more closely. They do not take them at face value any longer and are willing to look behind the structure at the reality of the situation to determine whether the trust is genuine or merely a façade which should be ignored. The trust may be found to be a sham, because it was set up to conceal the reality,<sup>58</sup> or it may be held to be the alter ego of the settlor, trustee or beneficiary.<sup>59</sup>

This development is particularly evident in relationship property proceedings. As explained above, the ability to access trusts under the PRA is constrained by the requirements of s 44C. If the assets were already in trust when the relationship began, or if the trust acquired the assets directly from a third party, rather than from either spouse or partner, s 44C is of no use. But the sham and alter ego trust doctrines may provide a remedy.

If the trust was set up as a sham, it was never a trust in the first place and is treated as void ab initio.<sup>60</sup> More often, however, the trust is established for legitimate reasons, but over time has become the alter ego of the person controlling the trust, where the controller overrides the trustee's discretion. The controller in effect dominates the trustee(s) who are mere puppets of the controller.

In the relationship property context, one of the spouses or partners is typically the controller. He or she may also be one of the trustees alongside another trustee who leaves

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<sup>56</sup> R Stock, 'If your trust's gathering dust, check it's not an "alter ego"' *Sunday Star-Times* (Auckland, New Zealand) 24 December 2004.

<sup>57</sup> For example, *Niak v MacDonald* [2001] 3 NZLR 334 (CA); *Begum v Ali* (Unreported, Family Court Auckland, FAM 2001-004-866 10 December 2004, O'Donovan, J).

<sup>58</sup> *Snook v Land and West Riding Investments Ltd* [1967] 2 QB 786; *K v R* (2001) 21 FRNZ 504.

<sup>59</sup> *Prime v Hardie* [2003] NZFLR 481; *Glass v Hughey* [2003] NZFLR 865; *Begum v Ali* (Unreported, Family Court Auckland, FAM 2001-004-866 10 December 2004, O'Donovan J).

<sup>60</sup> For example, *K v R* (2001) 21 FRNZ 504.

the administration to the controller. In Australia the courts treat the assets in such alter ego trusts as a financial resource of the controller and take this into account when adjusting property between former spouses.<sup>61</sup> In New Zealand the courts have usually imposed a constructive trust on top of an alter ego express trust and then awarded the applicant a beneficial interest in the constructive trust.<sup>62</sup> Sometimes, they have even ignored the alter ego trust and treated the assets as beneficially belonging to the controller.<sup>63</sup> There are conceptual difficulties with this latter approach, but a discussion of those difficulties is beyond the scope of this paper.

The importance of the sham and alter ego jurisdiction for purposes of this paper is that it presents a further challenge to traditional property structures. Given the high use of trusts in New Zealand, particularly in the farming context, the courts' willingness to find that a trust is a sham or the alter ego of a controller increases the risk that a farming trust may be ignored or subject to challenge. The only way that can be avoided is by ensuring that the trust is managed properly with due regard to the obligations imposed by established trust law.

## CONCLUSION

The PRA creates new challenges for spouses and partners seeking to preserve traditional private property rights. The enhanced importance of relationship property rights flies in the face of private property rights. The courts' increased powers under the PRA have the potential to erode existing property structures that were thought to be secure. The expectations created by the PRA can also be felt beyond the Act. It is influencing the development of other remedies to override traditionally secure property structures. The development of the alter ego jurisdiction is a clear example.

While these developments can affect any type of property in which one or both spouses or partners have a direct or indirect interest, farms are particularly vulnerable. Farms are commonly a combination of home and business, of family and employment. Both parties are generally directly involved with the farm as an operation. Several of the new provisions in the PRA are easily satisfied in the farming context, leading to a division of assets in terms of the PRA. The PRA thus poses a real risk to the traditional farming culture and may endanger the economic viability of farms. Given New Zealand's heavy dependence on the agricultural sector, the PRA could adversely affect the national economy. We should therefore ask ourselves: have we gone too far in according spouses and partners such strong property rights?

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<sup>61</sup> *In the Marriage of Ashton* (1986) FLC 91-777; *In the Marriage of Stein* (1986) FLC 91-779; *In the Marriage of Goodwin* (1990) 101 FLR 386.

<sup>62</sup> *Prime v Hardie* [2003] NZFLR 481; *Glass v Hughey* [2003] NZFLR 865; *O v S* (Unreported, Family Court Dunedin, FAM 2004-002-80, 12 December 2006, O'Dwyer, J).

<sup>63</sup> For example, *C v C (No 2)* [2006] NZFLR 881.