

## Protecting Children's Interests in Relationship Property Proceedings

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### I Introduction

When spouses, civil union partners, or de facto partners separate the focus in any ensuing relationship property proceedings is naturally on the property rights of the parties to the relationship. As s 1C of the Property (Relationships) Act 1976 explains:

This Act is mainly about how the property of married couples and civil union couples and couples who have lived in a de facto relationship is to be divided up when they separate or one of them dies.

The use of the word “mainly” indicates that the Act is not solely concerned with the property rights of spouses and partners. The interests of children of the relationship, in particular, are relevant and must be taken into account. These interests are of such significance that they feature as one of the purposes of the Act in s 1M(c):

to provide for a just division of the relationship property between the spouses or partners when their relationship ends by separation or death, and in certain other circumstances, *while taking account of the interests of children of the marriage or children of the civil union or children of the de facto relationship.* (emphasis added)

Section 26(1) gives explicit effect to the Act's purpose in relation to minor or dependent children of the relationship by directing the court to have regard to their interests in *any* proceedings under the Act. So, while the main purpose of the Act is to divide the relationship property of the spouses or partners, a just division *must* take account of the interests of minor or dependent children of the relationship.<sup>1</sup> Section 1M(c) is not confined to minor or dependent children. It is capable of applying to all children of the relationship.

Yet, in spite of the Act's stated purpose and the mandate in s 26(1), children's interests, including those of minor or dependent children, have not played a prominent role in relationship property proceedings.<sup>2</sup> To the extent that children's needs and interests require protection, the courts have generally adopted a minimalist approach to avoid depriving

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<sup>1</sup> Section 26 is more fully discussed below.

<sup>2</sup> See also Anna-Marie Skellern “Children and the Property (Relationships) Act 1976” (LLM Dissertation, Victoria University of Wellington, 2012).

the parties of their relationship property entitlements. In proceedings concerned with the division of property between the two parties to the relationship, the focus on the parties' rights may even deprive the children of beneficial interests in property legally owned by the parties. That risk is greater when the children are young or dependent and not in a position to safeguard their own interests. Because the proceedings are between the parties to the relationship, the children's perspective is not before the court unless it assists a party's case or the court realises that the children's interests are in jeopardy.

This paper has two aims. Its first aim is to alert readers to the range of property interests that children may have in assets owned by the parties to the relationship and how they might be better protected. Taking account of children's interests goes well beyond identifying their property interests. Section 26(1) requires children's interests to be considered whenever relationship property matters are addressed. This mandate acknowledges the adverse effect that a division of relationship property may have on children of the relationship. Accordingly, the second aim of this paper is to consider the extent to which children's interests are taken into account and whether there is scope to give better effect to this duty.

## II Preliminary comments

Before embarking on the substantive discussion, three preliminary comments must be made. The first is that the current Act is no minor amendment of the old Matrimonial Property Act 1976. Although the 2001 Act is in the form of an amendment, it significantly reforms the core provisions of the 1976 Act. Even seemingly minor changes to sections have wide ranging ramifications, often going well beyond the amended section. Some of the consequences may not have been envisaged or even intended by the legislature. The legislative process does not suggest that Parliament considered the Act's reforms in a holistic manner. Given the scope and nature of the reforms, it is important to treat jurisprudence and commentary developed under the old Act with caution.<sup>3</sup> Even provisions that are substantively unchanged call for a fresh perspective to ensure the amended Act is given its full effect and its impact on children of the relationship is carefully considered.

The second preliminary comment is that the Act is social legislation, capable of responding to changing societal values and socio-economic circumstances. Three relevant changes in the past two decades are the unparalleled use of trusts, New Zealand's ratification of the United Nations Convention on the Rights of the Child in 1993 and the Global Financial Crisis. Family trusts often place significant family assets outside

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<sup>3</sup> In her keynote address to the Family Court Judges' triennial conference in 2011, Elias CJ questioned whether the bench was being too deferential to precedent, which was detracting from a fresh look in response to the 2001 amendments.

the ambit of the Act. Attempts to bring those assets within the scope of the Act reflect the expectations of parties to the relationship and a growing belief in society that those expectations are reasonable.<sup>4</sup> But those attempts may well come at the expense of the interests and even the rights of children of the relationship.

New Zealand's ratification of the Convention on the Rights of the Child acknowledges its general endorsement of the rights articulated in the Convention. Articles 3, 12 and 27 are particularly relevant to relationship property proceedings. They deal with the child's wellbeing, the child's right to be heard, and the child's living conditions. While the Convention has not been adopted into domestic law, the courts do take note of it, particularly in care proceedings, and they construe domestic legislation to accord with the Convention.<sup>5</sup> In the context of relationship property proceedings, however, the Convention is rarely mentioned.<sup>6</sup> The need to consider international and domestic obligations is especially acute in a Global Financial Crisis. When finances are stretched, children are more likely to be adversely affected by a property division. These socio-economic changes call for a revised approach to the Act's property sharing regime.

The third comment relates to the Act's wide meaning of "child of a marriage" and other relationships covered by the Act.<sup>7</sup> It includes not only a child of both parties to the relationship, but also any other child, whether or not a child of either spouse or partner, if the child was a member of the family of the spouses or partners when their relationship ended. In *GM v JL* the Court held that to qualify as a "child" for purposes of the Act, the child must be wholly or partially dependent on one or both of the parties to the relationship for physical, material, emotional or social support.<sup>8</sup> To qualify as a "member of the family" the child must have some presence in or belonging to the couple's household. The definition therefore includes stepchildren, foster children and whangai living with the couple on a part time or full time basis. In the case of shared parenting, the child might be a member of more than one household and qualify as a child of more than one relationship.

Conversely, children of either or both parties to the relationship who have no presence in the parties' household are not children of the

<sup>4</sup> Law Commission *Review of the Law of Trusts – A Trusts Act for New Zealand* (NZLC R 130, 2013) at 232 and case law and commentary discussed in III B 4 below.

<sup>5</sup> *Tavita v Minister of Immigration* [1994] 2 NZLR 257 (CA); *K v P* [2004] 2 NZLR 421.

<sup>6</sup> *Hislop v Hislop* (2004) 23 FRNZ 710 and *DPC v PMB* [2013] NZFC 1105 are rare examples where the Convention was referred to as part of the justification for making orders relating to the home in the interests of the children. The latter case cites the earlier version of this paper mentioned in the opening footnote. Skellern, note 2, argues persuasively that New Zealand is in breach of its obligations under the Convention.

<sup>7</sup> Property (Relationships) Act 1976, s 2.

<sup>8</sup> *GM v JL* (2005) 24 FRNZ 835.

relationship. On a literal construction of the definition, their interests do not have to be taken into account in the parties' relationship property proceedings, not even if they are minors or dependent. Fortunately, the courts have not excluded consideration of those children's interests.<sup>9</sup>

In this paper, unless the context requires otherwise, the term "child" is used to include both a child of the relationship and a child of either of the parties to the relationship who is not a child of the relationship. In the cases relied on in this paper the children were all offspring of one or both of the parties to the relationship. For the sake of convenience, the term "parents" may be used even where one of the parties is a stepparent.

### III Protecting children's property interests

The starting point in any relationship property claim is to determine what property each of the parties owns. The Property (Relationships) Act applies only to property beneficially owned by the parties to the relationship. The definition of "property" in s 2 came from the Property Law Act 1952. It includes real and personal property, any estate or interest in such property, any debt or thing in action, and any other right or interest. The term "owner" is defined as "the person who, apart from this Act, is the beneficial owner of the property under any enactment or rule of common law or equity".<sup>10</sup> As both definitions draw on the general law, Parliament must have intended property ownership to be given its ordinary legal meaning, rather than any special meaning. That is how, for the most part, the courts have construed and applied the terms.<sup>11</sup>

#### A Protecting children's beneficial ownership of property

When ascertaining what property the parties own, it is not uncommon for one of the parties to claim that a third party is the beneficial owner of some item of property, for example a parent or a child. Usually one of the parties to the relationship asserts the claim. In *Sydney v Sydney*, for example, where Graham Sydney's second wife claimed that the family chattels included his art work displayed in the home, Mr Sydney argued successfully that he held one of the paintings, valued at \$120,000, on trust for his children from his first marriage.<sup>12</sup> After he had completed the work in 1992, he told his first wife that the painting was for their children and that he would hold on to it until they reached adulthood. That statement did not constitute a gift, because there was no actual or constructive delivery of the painting.<sup>13</sup> But the statement sufficed as a

<sup>9</sup> In *Public Trust v Whyman* [2004] NZFLR 688, for example, the minor children of the deceased were not children of his relationship with his de facto partner. Yet, their interests were the sole reason for the Public Trust seeking to bring relationship property proceedings.

<sup>10</sup> Property (Relationships) Act 1976, s 2.

<sup>11</sup> *Nation v Nation* [2005] 3 NZLR 46 (CA), where the ordinary meaning of a discretionary interest in a trust was applied.

<sup>12</sup> *Sydney v Sydney* [2012] NZFC 2685.

<sup>13</sup> *Williams v Williams* [1956] NZLR 970.

declaration of trust. It met the three certainties required for a valid trust: certainty of intention, certainty of subject matter, and certainty of objects. As Mr Sydney did not beneficially own the painting, it was excluded from the pool of relationship property.<sup>14</sup>

In that case Mr Sydney was looking out for his children's interests in the relationship property proceedings following the breakdown of his second marriage. The infant daughter in *L v P* was not so lucky.<sup>15</sup> Mr L and Ms P lived together for about 4 years between 2001 and 2006 (excluding two periods of separation). In January 2002 Mr L bought a home and registered it in his own name. The \$285,000 purchase price was funded by a mortgage of \$200,000 and the balance from his separate property. In November 2002 the couple's daughter, K, was born. The following year Mr L's sister died. She left the residue of her estate equally to L and K, with K's share to be invested by L until her 18th birthday. In June 2004 Mr L received just under \$288,000 from his sister's estate on behalf of himself and K. Instead of investing K's half share (about \$144,000), he used \$248,000 of the inherited funds to pay off the mortgage and make improvements to the home. The rest of the inheritance was untraceable. When the couple separated in 2006 Mr L continued to occupy the family home while Ms P moved into rented accommodation with K. Ms P claimed a half share of the home, which by then had increased in value to \$460,000.

When the matter first came before the Family Court, Ms P wanted the Court to determine the parties' relationship property entitlements without having regard to any rights or claims that K might have as a result of her father's misappropriation of her inheritance. Ms P intimated that she intended to bring proceedings against Mr L in the High Court to deal with his misappropriation. The Family Court rejected that approach. In carrying out its primary function of ascertaining and dividing relationship property it could not ignore that a very substantial sum, to which neither Ms P nor Mr L were entitled, had been absorbed into their primary asset, the family home, to their significant advantage.<sup>16</sup> In view of K's infancy and her parents' attitude towards her inheritance, the Family Court appointed independent counsel to represent K and protect her interests.<sup>17</sup> The question was what sort of interest or claim K had and how best to protect it. As both the Family Court and the High Court concluded, the answer lay in the equitable remedies for breach of trust.<sup>18</sup>

<sup>14</sup> See also *M v M* FC Manukau FAM-2006-092-3020, 22 June 2009.

<sup>15</sup> *L v P* HC Auckland CIV-201-404-6103, 17 August 2011; on appeal from *DP v UL* FC North Shore, FAM-2007-044-000882, 17 August 2010.

<sup>16</sup> *DP v UL* FC North Shore, FAM-2007-044-000882, 17 August 2010 at [29].

<sup>17</sup> Section 37A Property (Relationships) Act 1976 provides for appointment of a lawyer to represent a child of the relationship if special circumstances exist to make the appointment necessary or desirable.

<sup>18</sup> This case is discussed by Jessica Palmer and Nicola Peart in "Trust principles overlooked" [2011] NZLJ 423.

As a trust beneficiary, K had the right to trace her misappropriated inheritance into whatever assets her parents had acquired with the funds. As a proprietary claim by K would affect her parents' relationship property pool, determining the extent of K's interest was within the Family Court's jurisdiction.<sup>19</sup>

The first question was whether the \$40,000 that was untraceable should be allocated to K or her father. In other words, how much of K's inheritance was used to repay the mortgage. The Family Court and the High Court came to opposite conclusions on this point.

The Family Court held that all of K's inheritance had been used on the home, thus allocating the untraceable funds entirely to Mr L. Although the Court did not refer to any trust law authority, its approach accorded with conventional tracing principles where trust money is mixed with the trustee's own money.<sup>20</sup> Any withdrawals from such a mixed fund that are untraceable are attributed to the trustee and any withdrawals that are traceable into another fund or asset can be claimed as trust property. This approach protects the vulnerable beneficiaries and prevents trustees from profiting from their wrongdoing. Ms P objected to the effect that this ruling had on her relationship property entitlement and appealed the decision.

The High Court upheld her appeal, disagreeing with the Family Court's approach to K's tracing claim. It held that for purposes of assessing the rights as between Mr L and Ms P, any adverse consequences of Mr L's breach should be visited fully upon Mr L before any were visited on Ms P. Mr L was therefore deemed to have first used his own inheritance on the home before resorting to his daughter's inheritance. So, all of Mr L's inheritance and only part of K's legacy was attributed to the \$248,000 spent on the home. K was left to pursue her father personally for the balance of her misappropriated inheritance.

This approach does not accord with conventional tracing principles. While the assumption in a mixed fund that a trustee withdraws his own funds first before drawing on trust funds reflects the principles stated in *In re Hallett's Estate*, those principles were varied in *Re Oatway* to avoid trustees profiting from their wrongdoing at the expense of the beneficiaries.<sup>21</sup> The High Court did the opposite. It allowed Mr L to profit at K's expense and left her vulnerable to the risks of a personal claim against Mr L. Furthermore, Ms P's knowledge of her partner's wrongdoing was never canvassed. Unless she was a bona fide purchaser for value without notice of the source of the mortgage repayment, which seems unlikely, she was in no better position than Mr L.

The next question was how to recognize K's proprietary interest. The Family Court deducted the amount it had attributed to K's inheritance

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<sup>19</sup> On the Family Court's equitable jurisdiction, see *Yeoman v Public Trust* [2011] NZFLR 753 (HC).

<sup>20</sup> *In re Oatway* [1903] 2 Ch 356.

<sup>21</sup> *In re Hallett's Estate* (1880) 13 Ch D 696 (CA); *In re Oatway* [1903] 2 Ch 356.

from the value of the house and divided the balance equally between L and P. It had no jurisdiction to impose any proprietary remedies to protect K's interest.<sup>22</sup> Having acknowledged its jurisdictional limitations early on in the proceedings, it is surprising that the Court did not immediately transfer the proceedings to the High Court, rather than leaving any protection of the child's interests to the parties or an appeal.<sup>23</sup>

There was nothing to prevent the High Court from protecting K's interests. Under its inherent *parens patriae* jurisdiction it had the power and the duty to protect a child at risk, even if the child was not a party to the proceedings.<sup>24</sup> The Court made an order giving K a beneficial interest in the family home to be held by an independent trustee, but left the extent of K's interest to be determined by the parties. In the meantime counsel for K was directed to lodge a caveat to protect K's beneficial interest. If the home was sold, K's share of the proceeds would have to be conveyed to the independent trustee. If the home was not to be sold, the trustee would have to take title to an appropriate share of the property. This order did not appropriately protect K's proprietary interest either. Nor did it address her claim to the untraceable funds.

There were two complicating factors in K's tracing claim. The first was that some of the funds were used to repay the mortgage while the rest was spent on improvements to the home. Neither Court determined what portion of K's funds was used on the mortgage and what portion on the improvements. This distinction was relevant to the subject matter of K's proprietary interest. Trust funds used to acquire or improve property of the trustee entitle the beneficiary to choose whether to claim a proportionate share in the beneficial ownership of the property, or take a charge as security for a personal claim against the trustee.<sup>25</sup> To the extent that K's funds were expended on improving the house, she was entitled to a proportionate share of the home, including the increase in value from the date that her funds were used on improvements.

When trust funds are used to repay a mortgage, the established position is that the beneficiary is confined to the rights that the mortgagee had: a charge over the property for the repayment of the capital plus interest. There is some authority that supports the view that a beneficiary should

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<sup>22</sup> In directions made on 14 July 2009 Judge Ryan confirmed that the Family Court had no jurisdiction to deal with claims relating to the Trust and the child's inheritance: *DP v UL* FC North Shore FAM-2007-044-882, 17 August 2010.

<sup>23</sup> Property (Relationships) Act 1976, s 22 gives the Family Court power to transfer the proceedings to the High Court if that is the more appropriate venue for dealing with the proceedings because of their complexity. For example, *KMH v CLH* [2012] NZHC 537; [2012] NZFLR 688, where the existence of trusts and the likelihood of orders outside the Family Court's jurisdiction justified the transfer. See also the Property (Relationships) Amendment Act 2013 which amends s 22 to clarify the range of factors relevant to applications for transfer to the High Court.

<sup>24</sup> *L v P* HC Auckland CIV-201-404-6103, 17 August 2011 at [84].

<sup>25</sup> *Foskett v McKeown* [2001] 1 AC 102.

be able to claim a share of the beneficial ownership of the asset itself. This is known as “backward tracing”. Its availability is controversial.<sup>26</sup> As a substantial proportion of K’s inheritance was used to repay the mortgage, the Court order represents a significant departure from the established position on tracing. Depending on her parents’ determination of her interest, she may gain a greater interest in the property than she was entitled to. As a beneficial owner of the home, she would share in any increase in value from the date that her inheritance was used to repay the mortgage, rather than only receiving interest on the use of her capital. In view of the current increase in house prices, it could make a significant difference to K’s financial position.

On the other hand, by leaving it to the parents to determine the extent of K’s interest in the home and not protecting her claim to the untraceable funds, K was at risk of losing some of her property. The Court’s disregard of fundamental principles of trust law thus resulted in a failure to take proper account of K’s interests in breach of the mandate in s 26(1).

This case reveals the need for vigilance when ascertaining property ownership in a relationship property dispute. When the focus is on the relationship property rights of spouses or partners it is easy to overlook the property rights of children, particularly if the children cannot speak for themselves and their parents do not appreciate the legal consequences of their actions. Mr L may have thought he was acting in the best interests of his family by using the inheritance to pay off the mortgage on the family home. He may even have regarded it as a good investment for his daughter, but it was nonetheless a breach of trust. His daughter’s interests were jeopardised because her rights as a beneficiary were caught up in the relationship property dispute of her parents, neither of whom, it seems, could be trusted to protect her interests.

Both *L v P* and *Sydney v Sydney* are examples of express trusts. Children may also have a constructive trust claim to property legally owned by their parents either on the basis of a common intention,<sup>27</sup> or the *Lankow v Rose* reasonable expectations test.<sup>28</sup> Because of the requirements for this type of claim, the children are more likely to be adult and better able to protect their interest in relationship property proceedings between their parents.

### **B Protecting children’s discretionary interests in trusts**

Children are more often beneficiaries of an express discretionary trust, in which case they have no property in the trust assets until such time as the trustees exercise their discretion in favour of one or more of

<sup>26</sup> LD Smith “Tracing into the payment of a debt” (1995) 54 CLJ 290; Matthew Conaglen, “Difficulties with tracing backwards” (2011) 127 LQR 432.

<sup>27</sup> *Gough v Fraser* [1977] 1 NZLR 279 (CA); *Potter v Potter* [2005] 2 NZLR 1 (PC); *Richardson v Cassin* CA 24/03, 27 November 2003 and *Harvey v Beveridge* [2013] NZHC 1718.

<sup>28</sup> *Lankow v Rose* [1995] 1 NZLR 277, (1994) 12 FRNZ 682, [1995] NZFLR 1 (CA).



the children.<sup>29</sup> But they do have a potential interest and a right to be considered.<sup>30</sup> The trustees have a corresponding duty to make a genuine decision whether to appoint income or capital to one or more of the children as part of the trustees' overall obligation to perform the trust honestly and in good faith.<sup>31</sup> Trustees must not act capriciously or fetter their discretion. When exercising their discretion, they must take into account relevant considerations and ignore irrelevant considerations. Beneficiaries, including discretionary beneficiaries, have the right to hold the trustees to account for the performance of their duties.<sup>32</sup> To that end beneficiaries have a range of personal and proprietary remedies available to enforce the trust.<sup>33</sup>

Family trusts in New Zealand are commonly settled by one or both parents for the benefit of themselves, their children and remoter issue. The parents are often trustees, with or without an independent co-trustee, and one or both of the parents tend to hold the power to appoint and remove trustees. They may also have reserved the power to add and remove beneficiaries. In their capacity as trustees, they normally have broad discretionary powers to appoint income and capital to any of the beneficiaries, including themselves.<sup>34</sup> By means of these powers parents are perceived to control the trust for their own benefit. While their relationship is on foot, their children are likely to share in benefits their parents derive from the trust. The children may even benefit directly from appointments of income or capital. But when their parents separate, the trust is often an obstacle to achieving equality between the parties.

If both parties are trustees and hold the power to appoint and remove trustees, they may become deadlocked and unable to agree on the exercise of their administrative and dispositive powers.<sup>35</sup> Where the trust property is occupied by one of the parties, as is often the case when the major trust asset is the family home or a farm, the effect of a deadlock is that the party in occupation continues to benefit from the trust, while the other

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<sup>29</sup> *Kain v Hutton* [2008] NZSC 61, [2008] 3 NZLR 589; *Nation v Nation* [2005] 3 NZLR 46, (2004) 23 FRNZ 783 (CA).

<sup>30</sup> *Hunt v Muollo* [2003] 2 NZLR 322 (CA); *Johns v Johns* [2004] 3 NZLR 202 (CA).

<sup>31</sup> *Armitage v Nurse* [1998] Ch 241 (CA).

<sup>32</sup> *Foreman v Kingstone* [2004] 1 NZLR 841.

<sup>33</sup> They may sue the trustees personally for loss or pursue proprietary remedies against the trustees or third party recipients. They may also pursue claims against strangers for knowing receipt or knowing assistance. But such property or compensation as is recovered reverts to the trust. Hence, the most common remedy discretionary beneficiaries seek is the removal of trustees on grounds of hostility, failure to perform the trust or expediency: Trustee Act 1956, s 51.

<sup>34</sup> A clause providing for majority decision-making is commonly inserted to avoid trustees making decisions to benefit themselves.

<sup>35</sup> *Koornneef v Koornneef* HC Wellington CIV-2010-485-2444, 8 March 2011; *KAMG v STG* (aka *Anderson v Anderson*) [2013] NZHC 1767.

party is excluded.<sup>36</sup> The unequal effect is even more pronounced where the power to remove trustees is held by only one of the parties, who then exercises the power to remove their former spouse or partner as trustee. While that avoids a deadlock, it is also very likely to reduce any future benefit the former spouse or partner might receive from the trust and to create inequality in the parties' bargaining strengths in negotiations to reach a property settlement.<sup>37</sup>

Where a trust gives rise to inequality, the disadvantaged spouse or partner is likely to look for remedies aimed at accessing the assets held in trust in an attempt to share equally in the property associated with the relationship. Sections 44 and 44C of the Property (Relationships) Act are designed to deal with dispositions that defeat the relationship property rights of a spouse or partner. If the parties were married or in a civil union, then s 182 Family Proceedings Act 1980 may assist. Where none of the statutory remedies achieves the desired outcome, the courts have been sympathetic to arguments that the trust assets should be treated as beneficially belonging to one or both of the parties to the relationship on the basis of their powers to control the trust for their own benefit.

The difficulty with these remedies and arguments is that they are raised in relationship property proceedings where the focus is on giving effect to a dominant social policy of equality between parties to a relationship. The interests of other trust beneficiaries, including children of the separated couple, are subordinated to the policy of equality between the parties, even though both the Property (Relationships) Act and the general law mandate that children's interests should be considered and protected in whatever way is appropriate.

### 1 Dispositions intended to defeat rights

Section 44 Property (Relationships) Act 1976 gives the court power to set aside dispositions of property that were intended to defeat the relationship property rights of a spouse or partner. Prior to the Supreme Court ruling in *Regal Castings v Lightbody*,<sup>38</sup> proof of intent required evidence of a fraudulent motive or purpose: a conscious desire to remove relationship property from the reach of the courts.<sup>39</sup> This test rendered s 44 of little use. Dispositions to trusts were safe as long as defeating the rights of one of the spouses was not the end which the disposition was intended to achieve. A disposition intended to benefit children of the relationship was not vulnerable under this test, even if it had the effect of depriving a spouse or partner of their relationship property entitlement.<sup>40</sup>

<sup>36</sup> For example, *Nation v Nation* [2005] 3 NZLR 46, (2004) 23 FRNZ 783 (CA); *Ward v Ward* [2009] NZSC 125; [2010] NZLR 31; *Begum v Ali* FAM-2001-004-000866, 10 December 2004.

<sup>37</sup> *Kilkelly v Arthur Watts Savage Legal* HC Invercargill CIV-2006-425-148, 23 July 2007.

<sup>38</sup> *Regal Castings v Lightbody* [2008] NZSC 87; [2009] 2 NZLR 433.

<sup>39</sup> *Coles v Coles* (1987) 3 FRNZ 101; 4 NZFLR 621 (CA) at 105 and 625.

<sup>40</sup> For example, *Coles v Coles* (1987) 3 FRNZ 101; 4 NZFLR 621 (CA); *Gerbic v Gerbic* (1991) 8 FRNZ 518; [1992] NZFLR 481.

In *Regal Castings v Lightbody*, in the context of very similar wording protecting creditors in s 60 of the Property Law Act 1952, the Supreme Court held that intent did not require a fraudulent motive or purpose. Rather, the creditors had to show that the respondents knew or ought to have known that by disposing of the property they were significantly increasing the risk that the creditors would not be able to recover the amounts owing to them.

This test has since been applied to s 44.<sup>41</sup> But the implications of this new test in the relationship property context have yet to be fully considered. Would a disposition into trust for the benefit of children be caught if the transferor knew at the time that it would have the effect of defeating the relationship property rights of their spouse or partner? If the answer to that question is "yes", as the *Regal Castings* test suggests, then it will adversely affect the interests of the children for whose benefit the offending disposition was made.

Nonetheless, proving the required intent is still a significant hurdle. Knowledge cannot simply be inferred from the effect of the disposition.<sup>42</sup> It must be separately established. That requirement is less likely to be satisfied if both spouses or partners disposed of the property, as is often the case when couples settle a trust. Section 44 is more likely to apply where the property was transferred by one of the parties to the relationship. If that party knew at the time that by disposing of the asset into trust a future relationship property claim by their spouse or partner could be defeated, then the court may well conclude that the disposition was made with that intent.

Establishing a fraudulent intent does not necessarily mean that the disposition will be set aside. The court may make that order only if the transferees received the property otherwise than in good faith and for valuable consideration.<sup>43</sup> As the party who settled the trust is also often a trustee, he or she cannot rely on the defence. The settlor's co-trustees may also know of the settlor's intent or the settlor-trustee's knowledge may be attributed to them as joint recipients, as in *Regal Castings v Lightbody*.<sup>44</sup>

Even if the recipients have no defence to the claim, the court may still decline to set aside the disposition. It has a discretion whether to grant orders under s 44. It could decline to set aside the disposition if

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<sup>41</sup> *Ryan v Unkovich* [2010] 1 NZLR 434; [2009] NZFLR 948; *K v V* [2012] NZHC 1129. See also *Perriam v Wilkes* HC Auckland CIV-2009-425-284, 18 August 2011 where the test was applied to s 43 Property (Relationships) Act 1976.

<sup>42</sup> Several Family Court decisions, where the *Regal Castings*' test was held to have been met, were overruled because the intent was not proven: *K v V* [2012] NZHC 1129 overruling *AJV v ABGK FC* Wellington FAM-2009-085-1268, 2 December 2011; *Patterson v Davison* [2012] NZHC 2757, overruling *CHD v IAP* [2012] NZFC 5370. See also *Clayton v Clayton* [2013] NZHC 301 where the High Court remitted the matter back to the Family Court to identify the evidence in support of the intent requirement.

<sup>43</sup> Property (Relationships) Act 1976, s 44(2).

<sup>44</sup> *Regal Castings v Lightbody* [2008] NZSC 87; [2009] 2 NZLR 433.

it was intended to benefit the children of the relationship. The court may conclude that the children's interests outweigh the applicant's relationship property entitlement.

That was not the case in *JCF v DWG*, where in a settlement agreement, later set aside on grounds of duress and serious injustice, the respondent gave his former partner 25 per cent of her entitlement and transferred another 25 per cent into a trust for the benefit of their children.<sup>45</sup> He retained the other half of the relationship property pool and had complete control over the trust. As there was no reason to prefer the children over the applicant's rights, nor any justification for protecting the children's interests entirely at the expense of the applicant's rights, the trustees were ordered to transfer the property back to the applicant and respondent for equal division between them.

Section 44(2) gives the court a range of possible orders to remedy an offending disposition. The order can be made in favour of the applicant spouse or partner or such other person(s) as the court directs. The court could make an order in favour of children of the relationship. The order may also relate to only part of the disposition or to the value of the property rather than the property itself. There is therefore ample scope in s 44 to take account of the interests of children, both in relation to determining whether to set aside the disposition and how to remedy any adverse effect of the disposition. Yet, the case law to date reveals little acknowledgement of children's interests when applying s 44. The relationship property rights of the applicant spouse or partner seem to dominate at the expense of any interest that the children might have in the trust.

## 2 *Dispositions having the effect of defeating relationship property rights*

Section 44C Property (Relationships) Act 1976 performs a very different function from s 44. Its purpose is not to recover property for purposes of classification and division under the Act, but to order the respondent spouse or partner to compensate the applicant spouse or partner for the unequal effect of the disposition on the rights of the parties. The disposition of relationship property must therefore produce an unequal benefit as between the parties. Compensation is intended to restore equality between the parties in terms of the benefit that each enjoys from the disposition of relationship property to the trust.

Reflecting that purpose, the order is directed in the first instance at the respondent spouse or partner, not the trustees who received the property. Only if the respondent has insufficient property outside the trust to compensate the applicant does the court have power to make an order against the trustees, and then only to divert income from the trust to the applicant.<sup>46</sup> The court has no power to make an order against the capital of the trust. The integrity of the trust and the interests of the beneficiaries

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<sup>45</sup> *JCF v DWG* [2012] NZFC 5854.

<sup>46</sup> Property (Relationships) Act 1976, s 44C(3).

are thus protected, which was Parliament's intention.<sup>47</sup> However, the New Zealand Law Commission has recommended an amendment to s 44C to allow the court to make orders against the capital of the trust.<sup>48</sup> If that recommendation is accepted, it will jeopardise the integrity of the trust and prioritise the interests of spouses or partners at the expense of their children and other beneficiaries of the trust. Capital could be removed from the trust without constraint on its use or protection against it becoming relationship property of a subsequent relationship.

The court is not obliged to make an order under s 44C. It has a discretion to award compensation "if it considers it just to do so".<sup>49</sup> Quantum is also at the court's discretion. In deciding whether to make an order and how much compensation to award the court is directed to have regard to a range of factors, including whether any children of the relationship are or have been beneficiaries of the trust and any other relevant matter.<sup>50</sup> The extent to which the children are or were dependent on the trust for support or may be in the future will be an important consideration, especially if parental finances are stretched. Unlike s 44 where children's interests are not mentioned, the explicit reference to children in s 44C provides some assurance that their interests will be taken into account when compensation for a disposition of relationship property is sought by one of their parents. To date, however, there is little evidence of children's interests affecting compensation orders in favour of one of their parents.

### 3 Section 182 Family Proceedings Act 1980

Section 182 Family Proceedings Act 1980 gives the court a broad discretion to vary a nuptial settlement on the dissolution of a marriage or civil union.<sup>51</sup> Trusts settled by one or both spouses or civil union partners for the benefit of themselves and their children qualify as nuptial settlements.<sup>52</sup>

Section 182 is one of the few provisions where the interests of children play a prominent role. As the Court of Appeal said in *X v X*:<sup>53</sup>

<sup>47</sup> Government Administration Committee Report on the Matrimonial Property Amendment Bill No 109-2 at xii.

<sup>48</sup> Law Commission *Review of the Law of Trusts – A Trusts Act for New Zealand* (NZLC R 130, 2013) at 232.

<sup>49</sup> Property (Relationships) Act 1976, s 44C(4).

<sup>50</sup> Property (Relationships) Act 1976, s 44C(4)(e) and (f).

<sup>51</sup> Section 182 cannot be invoked when a de facto relationship ends. The New Zealand Law Commission has recommended that s 182 be amended to include de facto relationships and to make separation, rather than divorce, the crystallising event: Law Commission *Review of the Law of Trusts: A Trusts Act for New Zealand* (NZLC R 130, 2013) at 239.

<sup>52</sup> *Ward v Ward* [2009] 3 NZLR 336 (CA); *Ward v Ward* [2009] NZSC 125; [2010] NZLR 31.

<sup>53</sup> *X v X* [2009] NZFLR 956 at [52]. See also *Williamson v Williamson* [1998] 16 FRNZ 580 and *MEF v J-APM* [2012] NZFC 7705.

In the breakdown of a marriage, children are particularly vulnerable to changes in material circumstances, and this is recognised in the language of s 182, which gives as a possible factor in the exercise of the Court's jurisdiction, benefits that may accrue to "the children of the marriage".

Although s 182 is intended to deal with the property consequences on dissolution of a marriage or civil union, it is not part of the Property (Relationships) Act and thus not underpinned by the purpose and principles of the Act's equal sharing regime. In *Ward v Ward* the Supreme Court held that s 182 should be used to restore to the greatest extent possible the reasonable expectations that the parties had of the settlement when it was made.<sup>54</sup> In that case the parties expected to benefit equally from the trust and so the Court ordered that half of the trust property be resettled on a trust for the wife on the same terms as the original trust. Rather than ordering the trustees to pay Mrs Ward half of the capital and leaving the remainder in trust for the husband, the resettlement put both parties on an equal footing and protected the interests of their children as beneficiaries of both trusts.

Since the Supreme Court ruling in *Ward v Ward* equal division has been the exception. In *DAM v PRM* and *LSP v WSP* the couples expected the land and the farms settled on trust to pass to their children.<sup>55</sup> The wives expected the trusts to provide them with suitable accommodation and a reasonable level of income. They did not expect to receive a share of the farmland. In both cases the Court orders reflected their expectations. The children's interests as beneficiaries of the trust were thus safeguarded.

In some cases the court has made specific provision for the children of the marriage by ordering that a percentage of the trust property be settled on a separate trust for the children.<sup>56</sup> Those trusts can then be placed under the control of an independent trustee to avoid ongoing conflict between the parents adversely affecting the administration of the trust to the detriment of their children.<sup>57</sup>

#### 4 General law arguments

The constraints of the statutory remedies has encouraged disappointed spouses and partners to look to the general law in an attempt to bring assets in a discretionary trust within the beneficial ownership of one or both of the parties to the relationship.<sup>58</sup> Following an obiter dictum of the

<sup>54</sup> *Ward v Ward* [2009] NZSC 125; [2010] NZLR 31.

<sup>55</sup> *DAM v PRM* FC Masterton FAM-2008-035-512, 30 March 2011. *LSP v WSP* FC Gore FAM-2007-017-124, 30 May 2011. See also *ML-S v RMS and CJ* [2012] NZFC 6152.

<sup>56</sup> *Williams v Williams* HC Christchurch CIV-2006-409-2948, 1 May 2009; *Ord v Ord* HC Auckland AP66-SW02, 28 March 2003; *MEF v J-APM* [2012] NZFC 7705.

<sup>57</sup> *X v X* [2009] NZFLR 956; *MEF v J-APM* [2012] NZFC 7705.

<sup>58</sup> For example, *LAR v DR* FC Auckland FAM-2009-004-001627, 19 November 2009; *JG v JBG* FC North Shore FAM-2007-044-591, 13 July 2010; *Grigson v Walker* [2012] NZFC 5566.

Court of Appeal in *Walker v Walker*, that the powers held by the spouses in respect of their trust together with their discretionary interests constituted a valuable “package of assets”, the Family Court has sometimes treated this package or “bundle of rights” as property in relationship property proceedings.<sup>59</sup>

At the heart of the “bundle of rights” argument are the powers that one or both of the parties have to control the trust for their own benefit. The argument has received both judicial and academic criticism for its disregard of fundamental trust law principles.<sup>60</sup> In the context of this paper, the criticism is worth noting for the argument’s disregard of children’s interests. The argument is made for the applicant’s personal gain and to the detriment of the children and other beneficiaries of the trust. If the argument succeeds, the value of the bundle of rights is treated as beneficially belonging to one or both of the parties and included in the relationship property pool for division between the parties.

Central to the criticism of the bundle of rights argument is its exclusive focus on the settlors’ powers. The reasoning ignores the obligations on the trustees to use those powers honestly and in good faith in the interests of all beneficiaries, any one of whom has the right to enforce the obligations owed to them.

The same criticism can be levelled at various unorthodox attempts to challenge the existence of trusts.<sup>61</sup> In *Clayton v Clayton*, for example, the High Court held that one of the trusts declared by Mr Clayton was “illusory”.<sup>62</sup> As the sole trustee and one of the discretionary beneficiaries and with a clause expressly permitting him to benefit from the trust, Mr Clayton had the power to do whatever he wanted with the trust property according to the Court. What he had in fact done was neither here nor there. Nor did it matter that he intended to establish a trust for legitimate business reasons and that his efforts were not a sham. It was the powers he had retained, which allowed him to deal with the trust property just

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<sup>59</sup> *Walker v Walker* [2007] 2 NZLR 261(CA); *JG v JBG* FC North Shore FAM-2007-044-591, 13 July 2010; *R v R* [2010] NZFLR 555 (FC); *LR v JR (A Bankrupt)* [Relationship property: Bundle of rights] [2011] NZFLR 797.

<sup>60</sup> For example, Heath J “Some thoughts on a (New Zealand) judicial approach to trust law”, paper presented at STEP New Zealand Conference in 2012; Shelley Griffiths, “Valuing ‘bundles of rights’ for the Property (Relationships) Act 1976: when neither art nor science is enough” (2011) 7 NZFLJ 98; Nicola Peart, Mark Henaghan and Greg Kelly, “Trusts and relationship property in New Zealand” (2011) 17 Trusts and Trustees 866; Anthony Grant in several articles in NZLawyer. For a contrasting viewpoint see Frances Gush “The ‘bundle of rights’ – Unraveling trust principles” (2012) 7 NZFLJ 157.

<sup>61</sup> *Harrison v Harrison* (2008) 27 FRNZ 202 (HC) where the Court held that the retention of powers meant that the parties had not separated the equitable estate from the legal estate. In *B v X* [2011] 2 NZLR 405 (HC) the Court held that the powers gave the settlor trustee a general power of appointment which was tantamount to ownership of the trust assets.

<sup>62</sup> *Clayton v Clayton* [2013] NZHC 301.

as he would if the trust had never been created.<sup>63</sup> The trust was therefore invalid and the assets still belonged beneficially to Mr Clayton.

The Court made no mention of Mr Clayton's duties as trustee. The clear inference is that the Court formed the view that Mr Clayton had no duties associated with his powers. If so, then his children, who were also beneficiaries of the trust, could not have held their father to account for breach of trust if he had chosen to appoint trust property to a non-object of the trust or if he had invested imprudently. Yet, if the children had made such a claim, it seems unlikely that the Court would have dismissed it on the basis that the trust did not exist. The Court of Appeal has granted leave to appeal this decision, as it did in two other cases where similar arguments were made.<sup>64</sup> The Court hinted in one of the leave decisions that it did not approve of the High Court's disregard for the formal structure, but the case settled before the appeal was heard.<sup>65</sup>

To the extent that these sorts of arguments depart from established legal and equitable principles for which the Property (Relationships) Act makes provision in its definitions of property ownership, there is no justification to ignore legitimate property structures in order to bring property into the relationship property pool. Both the definition of ownership in s 2 of the Act, mandating the application of general law, and the duty to take account of the interests of children of the relationship in s 1M(c) and s 26(1) militate against the development of special exceptions that serve the interests of parties to the relationship at the expense of their children.

By relying on the general law to define property ownership, Parliament must have intended to strike a balance between the social aims of the Property (Relationships) Act and the rights of third parties under property structures lawfully created by spouses and partners for legitimate reasons. That balance is central to the deferred nature of the relationship property regime, the protection of third parties (including creditors), and the limits imposed on remedies against third party recipients of relationship property.

#### IV Taking account of children's interests

Section 26(1) of the Property (Relationships) Act directs the court to have regard to the interests of any minor or dependent children of the relationship in any proceedings under the Act. That mandate goes some way to meeting the obligations in the UN Convention on the Rights of the Child to safeguard the child's wellbeing. The Act also gives the court specific powers to make orders for the benefit of minor or dependent children. But the direction in s 26(1) is not limited to

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<sup>63</sup> *Clayton v Clayton* [2013] NZHC 301 at [90].

<sup>64</sup> *Harrison v Harrison* [2009] NZCA 68; [2009] NZFLR 687 (CA); *D v B & CIR* [2011] NZCA 474.

<sup>65</sup> *Harrison v Harrison* [2009] NZCA 68; [2009] NZFLR 687 (CA) at [22], [26] and [29].



those powers. It requires the court to consider the interests of minor or dependent children against all the claims, rights and entitlements of the parties to the relationship. Children's interests may be relevant to the classification, valuation, and division of property even if the children have no beneficial interest in the property. Section 1M(c) does not limit the relevance of children's interests to minor or dependent children either. Adult children's interests should also be taken into account, where appropriate. Yet, children's interests tend to receive very little attention in relationship property proceedings and, where they do, their interests are protected to the minimum extent possible.

### **A Classification**

Classification of the parties' assets is central to the scheme of the Act, as only relationship property is divided between the parties.<sup>66</sup> Separate property is retained by the owner.

Sections 8 to 10 provide a set of rules for classifying the parties' assets. At first sight they appear to leave little scope for consideration of children's interests. There is no discretion and children's interests are not mentioned as a factor relevant to classification. On closer analysis, however, children's interests could affect classification. Whether a chattel is an heirloom or taonga, for example, will depend not only on the chattel's ancestry, but also on its intended future destination. The reason for removing these items from the definition of family chattels in s 2, and thus the relationship property pool, is to preserve them for future generations.

Similarly, in determining whether property was acquired for the common use or common benefit of both parties to the relationship under ss 8(1)(d) and (ee), it may be that some property was for the common use or benefit of only one of the parties and that party's children from a former relationship. To qualify as relationship property under either of those sections, the asset must have been acquired for the common use or benefit of *both* parties. By taking into account the interests of children, such assets may be classified as separate property of one of the parties, rather than relationship property.

Conversely, children's interests may be relevant to classifying what might otherwise be separate property as relationship property. For instance, property acquired from a third party by gift, survivorship, inheritance, or from a trust settled by a third party, retains its separate property status unless it is intermingled with relationship property.<sup>67</sup> The needs of children may well cause the separate property to become intermingled.

So even in the application of seemingly rigid rules, such as those governing classification of assets, taking account of the interests of

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<sup>66</sup> Property (Relationships) Act 1976, s 11.

<sup>67</sup> Property (Relationships) Act 1976, s 10.

children may produce a different outcome from one that overlooks those interests.

### **B Valuation of property**

Section 2G states that the value of property is to be determined at the date of hearing, unless the court in its discretion determines otherwise. The insertion of ss 18B and 18C in 2001 to deal with post-separation actions has significantly constrained the court's discretion to adjust the valuation date. As the High Court noted in *JAM v GFM*, s 2G creates a presumption in favour of a hearing date valuation.<sup>68</sup> The Court went on to say that the discretion is to be exercised in accordance with and subject to any limits arising from the purposes and principles of the Act. Yet, it held that "it was not open to the Judge to meet the needs of the children by altering the presumed valuation date designed to achieve equality between the husband and wife".<sup>69</sup> It was irrelevant that the children wanted to stay in the home after their parents separated, which was one of several factors that persuaded the Family Court to adopt the separation date valuation.<sup>70</sup>

The High Court ruling on this point is open to question and diverges from rulings in cases predating the amendments in 2001, where children's interests were taken into account.<sup>71</sup> While the discretion to opt for a different valuation date is narrower than it was before ss 18B and 18C were inserted, s 2G does not exempt the court from the duty to have regard to the interests of children of the relationship. The exclusion of their interests as a relevant factor disregards the duty imposed by s 26(1) and one of the stated purposes in s 1M of the Act. Leave to appeal the decision has been granted and may clarify the relevance of children's interests to the discretion in s 2G.<sup>72</sup>

### **C Division of relationship property**

In a relationship of more than three years' duration there is a strong presumption that all of the couple's relationship property will be divided equally unless the parties have opted out of the statutory sharing regime.<sup>73</sup> If they have not contracted out of the Act, there are only a few exceptions to the presumption of equal sharing. It does not apply to the division of an increase in value of the owner's separate property attributable to the actions of the non-owning spouse or partner.<sup>74</sup> The presumption can be rebutted if there are extraordinary circumstances that make equal sharing repugnant to justice.<sup>75</sup> Compensation orders

<sup>68</sup> *JAM v GFM* [2012] NZHC 290; [2012] NZFLR 469.

<sup>69</sup> *JAM v GFM* [2012] NZHC 290; [2012] NZFLR 469 at [133].

<sup>70</sup> *JAM v GFM* FC Auckland FAM-2006-004-2610. 4 November 2010 at [54].

<sup>71</sup> *Stephenson v Reidy* HC Auckland M16/98, 11 September 1998; *Matehe v Matehe* (1998) 17 FRNZ 343.

<sup>72</sup> *JAM v GFM* [2012] NZHC 2102; [2012] NZFLR 792.

<sup>73</sup> Property (Relationships) Act 1976, ss 11 and 21.

<sup>74</sup> Property (Relationships) Act 1976, s 9A(2).

<sup>75</sup> Property (Relationships) Act 1976, s 13.

and orders for the benefit of children, discussed later in this paper, may also result in an unequal division of relationship property.

1 *Division of increase in value of separate property attributable to actions of non-owning spouse or partner*

Section 9A(2) converts the increase in value of separate property into relationship property if the increase is attributable to the direct or indirect actions of the non-owning spouse or partner. The increase in value that is so attributable is then divided according to the contributions of each spouse or partner to the increase in value.<sup>76</sup> This method of division is at odds with the philosophy of the Act by requiring a property-based approach, rather than one based on contributions to the partnership.<sup>77</sup> But it does allow the interests of others to be accommodated.

In *Rose v Rose* the Supreme Court held that any increase in value resulting from inflation was to be treated as part of the contribution made by the owning spouse or partner, because it was related to ownership rather than actions of either party.<sup>78</sup> The Court did not consider increases resulting from actions or contributions of a child of the relationship. Unless the child is able to claim a beneficial share of the ownership on the basis of those contributions, any increase attributable to the child's actions should be equally allocated to each spouse or partner. The justification of ownership does not have the same force when the increase is attributable in part to the actions of a child of the relationship, unless the child's actions were remunerated by the owning spouse or partner.

2 *Extraordinary circumstances that make equal sharing repugnant to justice*

Establishing this exception has always been notoriously difficult.<sup>79</sup> A strong message from the Court of Appeal in 1979 about the Act's emphasis on partnership and equality has left very limited scope for the application of the extraordinary circumstances' exception in s 13 of the Act.<sup>80</sup> The high threshold remains even after the major amendments in 2001.<sup>81</sup>

<sup>76</sup> If the increase in value is attributable to the application of relationship property, the increase also becomes relationship property, but it is subject to the ordinary presumption of equal sharing: Property (Relationships) Act 1976, s 9A(1).

<sup>77</sup> Margaret Briggs and Nicola Peart, "Sharing the increase in value of separate property under the Property (Relationships) Act 1976: a conceptual conundrum" (2010) 24 NZULR 1.

<sup>78</sup> *Rose v Rose* [2009] 3 NZLR 1 (SC).

<sup>79</sup> Property (Relationships) Act 1976, s 13.

<sup>80</sup> *Martin v Martin* [1979] 1 NZLR 97 at 111. Mark Henaghan and Nicola Peart, "Relationship Property Appeals in the New Zealand Court of Appeal 1958–2008: the Elusiveness of Equality" in R Bigwood (ed) *The Permanent New Zealand Court of Appeal* (Hart Publishing, Oxford, 2009) 99–149.

<sup>81</sup> *De Malmanche v De Malmanche* [2002] 2 NZLR 838 at [140].

In view of the emphasis on equality, it is hardly surprising that children's interests have rarely justified a departure from equal division. The recent case of *WMM v SJM* is a rare example where a child's needs were the wife's main platform for seeking unequal division of a modest pool of relationship property.<sup>82</sup> The Family Court Judge was not unsympathetic to her argument and considered the wife's reliance on s 13 carefully. She had sole responsibility for the care of her severely disabled daughter from a former relationship and her own health was poor. She had also used \$100,000 of an inheritance she had received two years prior to separation to purchase a new family home that was better suited to the needs of her daughter and the couple's child. While the Court acknowledged the wife's very difficult circumstances, caused principally by her daughter's high and complex needs that made re-housing a very difficult exercise, they were not sufficient to justify prioritizing the daughter's interests over those of the husband. He had supported his stepdaughter financially post-separation and, due to his wife's health problems, resolution of his relationship property claim had been delayed for six years throughout which the wife had continued to occupy the family home.

The Court did take account of the respondent's unusual circumstances in setting a late start date for payment of occupational rent, as explained below. There were therefore other ways of addressing the child's needs that detracted less from her stepfather's entitlement. Nonetheless, the judgment does not rule out the possibility of a child's needs being so extraordinary that equal division of the relationship property would be repugnant to justice, though it is difficult to imagine a more deserving case. If the exception applies, division is based on the contributions of each party to the relationship. As the care of children of the relationship is one of the contributions listed in s 18, it will also be relevant to the division under s 13.

### 3 Compensation orders

There are several provisions in the Property (Relationships) Act that give the court discretion to make compensation orders. Sections 15 and 15A are intended to redress future economic disparity between the parties resulting from the division of functions within the marriage. Responsibilities for care of the children during the marriage and after separation are central to this type of compensation, though difficulties in proving the requirements and uncertainty about the formula for assessing quantum have deprived these provisions of much of their intended remedial purpose.<sup>83</sup> Regrettably, Bill Atkin's concerns about the utter confusion and incoherence of these provisions have been borne out.<sup>84</sup>

<sup>82</sup> *WMM v SJM* [2012] NZFC 5091.

<sup>83</sup> *X v X* [2009] NZCA 399; [2010] 1 NZLR 601.

<sup>84</sup> Bill Atkin, "Editorial: Courts trudge through statutory sludge" (2002) 4 BFLJ 31 and "Economic disparity – how did we end up with it? Has it been worth it?" (2007) NZFLJ 299. See also John Caldwell, "Developments in dispute resolution and achieving fairness in property division" in Bill Atkin (ed) *The International Survey of Family Law* (2009 edition, Jordan

Sections 15 and 15A differ from other compensation provisions in the Act in that they address the effects of the relationship on the parties' future earning capacity, whereas the other compensation provisions are concerned with inequality in the division of property. Even in property-focused compensation provisions, children's interests may affect whether compensation is awarded and its quantum. Children feature prominently in applications for post-separation contributions under s 18B and, to a lesser extent, in applications for post-separation diminution of the relationship property under s 18C.

(a) Post-separation contributions

Section 18B deals with a spouse or partner's post-separation contributions to the relationship. As the care of children of the relationship is the first contribution listed in s 18's definition of contributions to the relationship, one might expect this type of contribution to be highly relevant, particularly as separation generally brings about a change in child care responsibilities. Yet, there was a surprising divergence of opinion as to whether and to what extent the care of children should be treated as a post-separation contribution.<sup>85</sup> In *Loader v Loader* the Family Court thought that the contribution made by a custodial parent after separation was offset by that person's enhanced relationship with the child or children.<sup>86</sup> Any sacrifices that the parent with primary responsibility might make in caring for the children should be addressed through the economic disparity provision in s 15.<sup>87</sup>

In *G v B* the Family Court cautioned against some parents' temptation to put in place childcare arrangements with a clear motive of maximizing their own financial benefit.<sup>88</sup> The Judge went on to say that compensation under s 18B might nonetheless be appropriate "where one parent has abandoned childcaring responsibilities to the other or quite blatantly manipulated his/her financial circumstances so as to avoid proper payment of child support".<sup>89</sup> The power should therefore be exercised sparingly. *G v B* was not a case where compensation was appropriate. Mr B had at all times been willing to play a full role in the day to day care of the children and was paying child support. His lack of involvement was entirely due to Ms G's unilateral decisions and actions.

In *Chong v Speller* a full bench of the High Court confirmed that post separation care of children qualified as a contribution.<sup>90</sup> It also seemed to take a broader view of the circumstances in which compensation might be justified. It held that "care" referred to the non-monetary aspects of the contribution. Expenses associated with such care were

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Publishing, Bristol, 2009) 353 at 363.

<sup>85</sup> *RRH v MMH* FC New Plymouth FAM-2005-043-314, 9 February 2006.

<sup>86</sup> *Loader v Loader* [2003] NZFLR 553 at [55].

<sup>87</sup> *Loader v Loader* [2003] NZFLR 553 at [52]–[53].

<sup>88</sup> *G v B* FC New Plymouth FAM-2002-043-245, 1 December 2004 at [51].

<sup>89</sup> *G v B* FC New Plymouth FAM-2002-043-245, 1 December 2004 at [52].

<sup>90</sup> *Chong v Speller* (2004) 24 FRNZ 273.

covered by child support legislation. That view was endorsed in *JA v SNA [Economic Disparity]* where the High Court declined Mrs A's claim for post separation expenditure on the children.<sup>91</sup>

In my view, s 18B is not intended to provide such compensation. The section was intended to be a way of providing to a child caring spouse a capital sum which recognizes the fact that day-to-day care of the children has fallen on one parent by virtue of the separation.

The Court of Appeal confirmed the correctness of this view in *X v X*, declining Mrs X's application for her care of the parties' children post-separation. Section 18B was not to be used as an alternative to regular child support provisions. The Court of Appeal then went on to say:<sup>92</sup>

This is not a case in which Mrs X has been abandoned with sole responsibility for the children, or left in a hopeless financial position by her sole care of them.

This statement echoes the approach in *G v B* in limiting the power to compensate for post-separation care of children to a narrow range of circumstances.

Conversely, the retention of the family home by the spouse or partner with primary responsibility for minor or dependent children is often an important consideration in a court's decision to decline a claim for occupational rent by the other spouse or partner. The courts are sympathetic to the children's need for accommodation and their interests in not being uprooted from their home immediately after their parents' separation.<sup>93</sup> Occupational rent may then be offset against care of the children by the spouse or partner who retained use of the home.

The interests of children of the relationship are also often taken into account in determining the "relevant period" for post-separation compensation. That period runs from the date that the relationship ended until the hearing date.<sup>94</sup> The courts often shorten the period to give the parties time to sort out their immediate needs. Generally, the grace period is up to about six months. But in *WMM v SJM*, referred to earlier in the context of s 13, the Family Court allowed the wife a period of four and a half years' grace after separation because of the high and complex needs of her daughter from an earlier relationship and her primary responsibility for the care of the parties' daughter.<sup>95</sup> The occupation rent that she was required to pay her husband was thus reduced to 18 months rather than the full six years from separation to the hearing date.

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<sup>91</sup> *JA v SNA [Economic disparity]* [2008] NZFLR 297 (HC) at [24].

<sup>92</sup> *X v X* [2009] NZCA 399; [2010] 1 NZLR 601 at [160].

<sup>93</sup> For recent examples, see *RSQ v BQ* [2012] NZFC 7272 and *WMM v SJM* [2012] NZFC 5091.

<sup>94</sup> Property (Relationships) Act 1976, s 18B(1).

<sup>95</sup> *WMM v SJM* [2012] NZFC 5091.

(b) Post-separation diminution in value of relationship property

Section 18C differs from s 18B. It is concerned with actions in relation to property, whereas s 18B deals with contributions to the relationship.

To come within s 18C, the applicant has to establish that the respondent's deliberate actions or inaction materially diminished the value of the relationship property. As compared to s 18B, the case law on s 18C is sparse. While the High Court has now clarified that the action or inaction must be deliberate, rather than the diminution in value,<sup>96</sup> it has yet to determine what constitutes a "material" diminution and what factors might affect the court's discretion to award compensation.

Given the property focus of s 18C, the interests of children are less likely to be relevant than they are in s 18B. Nonetheless, factors relevant to the children might explain the reason for making an investment or failing to preserve an existing investment. No clear explanation was given in *WMM v SJM* for the wife's neglect of the family home that resulted in a \$5000 drop in its value.<sup>97</sup> She was ordered to compensate her husband for half the diminution. The wife was suffering from serious physical and psychological health issues and had the sole responsibility for her severely disabled daughter. Those factors may have affected her ability to carry out maintenance on the house to preserve its value, which would have been material to the Court's exercise of discretion. It is also open to question whether a \$5000 reduction in the value of the home constituted a material diminution for purposes of s 18B.

Section 18C applies to the same "relevant period" as s 18B.<sup>98</sup> A similar approach to the commencement date might therefore be appropriate in s 18C claims, particularly where the diminution in value is the result of a deliberate inaction. The party responsible for the inaction may have needed some time to adjust to the changes resulting from the separation. In the few cases where s 18C has been considered thus far, shortening the relevant period was not an issue.

## V Orders for the benefit of children

Sections 26 and 26A empower the courts to make orders specifically for the benefit of minor or dependent children of the relationship. Section 26 gives the court discretion to settle some or all of the relationship property for the benefit of the children, while s 26A allows the court to postpone the vesting of some or all of a party's share in the relationship property if immediate vesting would cause undue hardship for a spouse or partner with primary responsibility for the care of children of the relationship. Furthermore, when considering whether to make an occupation order or tenancy order in favour of one of the parties to the relationship, the court is mandated to have "particular regard" to the need to provide a

<sup>96</sup> *Hutt v Hodge* [2007] NZFLR 438; *PGO v MAB* HC Auckland CIV-2009-404-7143, 3 September 2010.

<sup>97</sup> *WMM v SJM* [2012] NZFC 5091.

<sup>98</sup> Property (Relationships) Act 1976, s 18C(1).

home for any minor or dependent children of the relationship.<sup>99</sup>

### A Section 26

Section 26 serves two purposes. Its first purpose is to direct the court in any proceedings under the Act to have regard to the interests of any minor or dependent children of the relationship. The second purpose is to empower the court to settle relationship property for the benefit of children of the relationship, which Heath J construed to refer only to minor or dependent children.<sup>100</sup> Such an order overrides any agreement the parties may have made under Part 6 of the Act. The fact that the parties cannot contract out of s 26 emphasizes the importance of children's interests in the division of relationship property.

The power to settle property for the benefit of children could be used to displace totally the property rights and claims of the parties to the relationship.<sup>101</sup> Cooke J, as he was in 1983, observed that the power should not be used lightly, but that its presence showed that an inflexible pattern was no part of the legislative philosophy.<sup>102</sup>

His Honour need not have feared that the power would be used frequently or in a radical way. Quite the opposite! A search of Briefcase and LexisNexis databases on s 26 applications reveals that orders settling property on the children were made in only 14 out of 45 cases. The courts were reluctant to embrace this power out of concern that it was being invoked simply to avoid equal division of the relationship property.<sup>103</sup>

Although the power is not constrained by any statutory criteria or guidelines, the courts have generally adopted a very restrictive approach by insisting on evidence of exceptional or extraordinary circumstances, such as criminal offending within the family or severe parental neglect.<sup>104</sup> In *R v R* Judge Adams presented 10 propositions of relevance to s 26 applications:<sup>105</sup>

- (1) Prima facie the matrimonial property is to be regarded as the property of the parties.
- (2) In every case where there are minor or dependent children the Court is obliged to have regard to the respective interests of each such child.

<sup>99</sup> Property (Relationships) Act 1976, ss 27, 28 and 28A.

<sup>100</sup> In *Babylon v Babylon* (2009) 27 FRNZ 622 at [76].

<sup>101</sup> *Walker v Walker* [1983] NZLR 560 (CA).

<sup>102</sup> *Walker v Walker* [1983] NZLR 560 at 565.

<sup>103</sup> *Coxhead v Coxhead* [1993] 2 NZLR 397; *Evans v Evans* FC Whangarei FP29/94, 17 January 1996; *Bradwell v Kennedy* HC Wellington CIV-2004-485-611, 23 March 2005.

<sup>104</sup> *RN v RN* (1985) 3 NZFLR 694; *R v R* [1998] NZFLR 611; (1998) 17 FRNZ 75. Priestley J noted this approach to s 26 applications in *Hammond v Hardy* [2007] NZFLR 910.

<sup>105</sup> *R v R* [1998] NZFLR 611 at 622. These propositions have since been referred to with approval, for example, in *R v R* [2007] NZFLR 177.



- (3) The context of the consideration of the welfare and interests of the children is “*In the light of the property division between husband and wife, to ensure their financial protection during minority or dependency*” (per Casey J in *Rhodes* (supra) – I note also the discussion of s 26 by His Honour Judge Inglis QC in *Wheeler v Wheeler* (1984) 2 NZFLR 385).
- (4) The Court is not precluded from considering the interests of adult children and may have jurisdiction under s 26 to settle property for the benefit of an adult child (*Voorburgh* (supra); *Roberts* (supra); *Lockie v Lockie* (1993) 11 FRNZ 81).
- (5) It will be the exceptional case where the consideration leads to an actual award for a child.
- (6) It would be a wrong principle to use s 26 to anticipate succession.
- (7) Default or inability of a parent to provide appropriate maintenance, upbringing, shelter or nurture for a child are relevant factors, whether or not the default is wilful.
- (8) In the general run of cases a s 26 order should not be used to substitute or supplement child support arrangements. Nonetheless the Court's discretion is unfettered by statute.
- (9) Section 26 is not a backhanded means of providing damages to a child for ordinary parenting shortcomings.
- (10) An award under s 26 must be reasonable in all the circumstances.

These propositions indicate that the courts have to be persuaded that there is a real need to depart from the equal sharing regime to provide for children of the relationship. The main purpose of the Act is to divide the property of the spouses or partners between them. The parties should then be entrusted to care and provide for their children as best they can. Only where that trust is not justified, whether for reasons within or beyond the parties' control, has the court been willing to intervene to protect the interests of children.

Even if the need to protect children has been made out, an order settling property on them tends to be a last resort, because it is in the nature of an expropriation.<sup>106</sup> Other less draconian measures are preferred, such as postponing the vesting of relationship property or an occupation order until the children cease to be dependent. The courts place great weight on the main purpose of the Act by making every effort to ensure that the interests of children impact to the least extent possible on the property entitlements of the parties to the relationship.

In *WMM v SJM*, for example, the complex and high needs of the wife's daughter, the wife's sole responsibility for her daughter's care and her own poor health, as well as her injection of inherited funds into the purchase of the family home, were not sufficient to deprive the husband

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<sup>106</sup> *S v C* (1998) 17 FRNZ 176.

of any part of his relationship property entitlement.<sup>107</sup> While the Court acknowledged the real difficulties that the wife would face moving her daughter to alternative accommodation, the only concession it made was to shorten significantly the relevant period for the husband's claim for post-separation occupational rent.<sup>108</sup>

The courts' self-imposed constraint on their power to settle property for the benefit of children of the relationship is well established, even though there is nothing in s 26 to support such a restrictive view of the power. It severely limits the court's discretion and does not sit well with the direction in the first part of s 26(1) or the UN Convention on the Rights of the Child.<sup>109</sup> As the constraint is a judicial gloss on the section, there is scope for a more liberal approach that provides better protection for minor or dependent children of the relationship whilst not losing sight of the parties' rights to a just division.

### B Section 26A

Section 26A empowers the court to postpone the vesting of any share in the relationship property, either wholly or in part, until a specified future date or the occurrence of a specified event. Strangely, given the more limited nature of this power as compared to the power in s 26, s 26A has very strict criteria. It can be exercised only if the court is satisfied that immediate vesting would cause undue hardship for a spouse or partner who is the principal provider of ongoing daily care for one or more minor or dependent children of the relationship. Furthermore, an order postponing vesting may be made only for as long as necessary and only to the extent necessary to alleviate the undue hardship.

This section was inserted into the Act in 2001 to clarify the availability of this power.<sup>110</sup> Unlike s 26, s 26A also clarifies that the power can be exercised only where there are minor or dependent children.

The purpose of s 26A is to enable the primary caregiver of children of the relationship to look after those children. Where both parties share the care of the children, as in *De Malmanche v De Malmanche*, the court has no jurisdiction to make the order.<sup>111</sup>

It is up to the primary caregiver to prove that undue hardship would arise if sharing was not postponed. The threshold is high.<sup>112</sup> The focus generally is on the applicant's financial circumstances and the socio-economic consequences of not granting the order, such as the effect on the children's schooling and social environment if they were required

<sup>107</sup> *WMM v SJM* [2012] NZFC 5091.

<sup>108</sup> The wife has lodged an appeal, which Heath J labeled as not hopeless, though somewhat of an uphill struggle: *SJM v WMM* [2012] NZHC 2659.

<sup>109</sup> United Nations Convention on the Rights of the Child, Art 3 and Art 27 are especially relevant.

<sup>110</sup> Section 33(3)(d) was used in the past to postpone vesting: *Evans v Evans* FC Whangarei FP29/94, 17 January 1996.

<sup>111</sup> *De Malmanche v De Malmanche* [2002] NZLR 838.

<sup>112</sup> *Hammond v Hardy* [2007] NZFLR 910 (HC) at [114].

to move.<sup>113</sup> The respondent's circumstances may also be relevant. In *RH v AF*, for example, the respondent was a committed mental patient and in *E v W* the respondent was in prison.<sup>114</sup> Neither respondent had immediate need of the property and their absence meant that the applicants had sole responsibility for the parties' children. Any misconduct by the respondent is not relevant unless there is some causal connection between that misconduct and the undue hardship that the applicant will suffer if vesting is not postponed. Section 26A is not to be used to punish the respondent, but to address the applicant's circumstances.

The high threshold may explain the small number of cases where orders under s 26A have been sought and made since the 2001 amendments came into force: only four orders out of a total of 13 applications. One of the reasons for the courts' reluctance to postpone vesting may be found in Priestley J's observation about social change in *Hammond v Hardy*:<sup>115</sup>

In the 1960s and 1970s, agreements were relatively commonplace whereby the primary caregiver and children would remain in a family home with its sale being delayed until certain stipulated events occurred. Social conditions, however, have changed with geographic relocation and relatively rapid re-partnering in the wake of broken relationships being commonplace.

The current global financial crisis and the consequential downturn in the economy creates another social change that may impact on a primary caregiver's ability to care for the children of the relationship and justify the postponement of sharing.

### C Occupation orders

Section 27(1) Property (Relationships) Act 1976 gives the court power to grant a spouse or partner the right to personally occupy the family home that forms part of the relationship property. Section 28A mandates the court to have "particular regard" to the accommodation needs of the couple's minor or dependent children. That obligation also accords with the UN Convention on the Rights of the Child, as noted in *Hislop v Hislop*.<sup>116</sup> In about 50 per cent of the cases decided since 2002 the needs of children of the relationship were the principal reason for granting occupation to the applicant spouse or partner.<sup>117</sup> In the other cases the personal needs of the applicant<sup>118</sup> or requirements relating to the property justified the order.<sup>119</sup> Where the order is made to provide accommodation for minor or dependent children, the duration of the order is often

<sup>113</sup> *S v W* HC Auckland CIV-2008-404-4494, 27 February 2009.

<sup>114</sup> *RH v AF* FC Auckland FAM-2005-004-1312, 27 January 2006; *E v W* (2006) 26 FRNZ 38.

<sup>115</sup> *Hammond v Hardy* [2007] NZFLR 910 at [114].

<sup>116</sup> *Hislop v Hislop* (2004) 23 FRNZ 710 at [7].

<sup>117</sup> Nicola Peart "Occupation orders under the PRA" [2011] NZLJ 356.

<sup>118</sup> For example, *Rawlings v Rawlings* [2009] NZFLR 643.

<sup>119</sup> For example, *B v B* HC Wellington CIV-2007-485-378, 20 March 2007.

linked to the social and educational needs of the children. Even then, the duration of the order is seldom longer than a year or two.<sup>120</sup>

As with other orders for the benefit of children, the courts exercise restraint in making occupation orders. They tie up the capital for the duration of the order and prevent the parties from moving on. Shared parenting and accommodation needs of new partnerships are also reasons for not granting occupation orders.<sup>121</sup>

#### *D Representation of children in relationship property proceedings*

Section 37A Property (Relationships) Act gives the court the power to appoint a lawyer to represent minor or dependent children of the relationship in proceedings under the Act, but only if the court is of the view that special circumstances make the appointment necessary or desirable. This power is seldom utilised. *L v P*, discussed above, is one of the few examples where independent counsel was appointed to represent the couple's infant daughter because her father's misappropriation of her inheritance affected the parties' relationship property. Without independent representation, minor or dependent children's interests are easily overlooked unless it is in the interests of one of the parties to place those interests before the court. The obligation in Art 12(2) of the Convention on the Rights of the Child to give the child the opportunity to be heard in proceedings affecting the child is rarely seen as relevant in relationship property proceedings.

In the past, the court could also order that the lawyer's fee and expenses be paid out of public money, rather than by either or both of the parties to the proceedings.<sup>122</sup> That power was repealed with effect from 2 September 2013.<sup>123</sup> The inability to charge the costs to the State may make the court reluctant to appoint a lawyer to represent the children. It may prevent the court from hearing argument on the child's perspective and prevent the child from having the opportunity to be heard, in breach of Article 12 of the Convention on the Rights of the Child.

<sup>120</sup> In a review of cases decided between 2002 and 2011 occupation orders were made in 18 cases. In five of those cases the duration of the orders ranged from 4 to 22 months. *S v W* HC Auckland CIV-2008-404-4494, 27 February 2009 was exceptional with an order for 5 years. In *Mark v Mark* [2004] NZFLR 72; (2003) 23 FRNZ 128 the wife was granted occupation of the home for as long as she had the care of the couple's severely disabled daughter. In *PEL v FFB* [2012] NZFC 9534 the Court granted the wife occupation for four years until the couple's youngest child completed year 12 at school. The wife was effectively a solo parent. The husband lived in Singapore and had little contact with the children.

<sup>121</sup> Bill Atkin and Wendy Parker *Relationship Property in New Zealand* (LexisNexis, Wellington, 2009) 11.4.1. For example, *JKK v LDK* [2005] NZFLR 881.

<sup>122</sup> Property (Relationships) Act s 37A(2).

<sup>123</sup> Property (Relationships) Amendment Act 2013.

## VI Conclusion

The Property (Relationships) Act directs the courts to consider the interests of children of the relationship. That mandate reflects New Zealand's obligations under the UN Convention on the Rights of the Child. Yet, children's interests play only a minor role in relationship property disputes.<sup>124</sup> Their interests are subservient to the main purpose of the Act, which is to divide relationship property between the parties to the relationship. Relationship property is seen as belonging to the parties and theirs to share. Apart from applications for orders for the benefit of children, the interests of children are seldom mentioned.<sup>125</sup> Even when considering orders for the benefit of children, the courts are rarely persuaded to depart from the Act's main purpose. Assets transferred into trust for the benefit of the parties and their children are not exempt from the Act's purpose and policy either.

Equal sharing of relationship property is such a dominant feature that the impact on children is easily overlooked or ignored. The assumption appears to be that children's interests can be safely entrusted to their parents. The reality may be rather different. In breach of the UN Convention on the Rights of the Child, the children's voice will not be heard unless it serves the interests of one of the parties to the proceedings or the court becomes aware of the need to take their interests into account. However, the power to appoint a lawyer to represent the children is limited and the repeal of the power to charge the costs of such an appointment to the State could further marginalise children's interests in relationship property proceedings. While there is scope within the Act to consider children's interests more widely than the courts currently do, legislative reform may be needed if children's interests are to be taken seriously.<sup>126</sup>

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<sup>124</sup> Skellern, n 2 at 5.

<sup>125</sup> *DPC v PMB* [2013] NZFC 1105 is a notable exception where the application under s 33 to sell the home was declined in the interests of the children.

<sup>126</sup> For proposed reforms see Skellern, n 2.

