Beyond reasonable **debt**

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Beyond Reasonable Debt, is the title of a recent New Zealand Families Commission (December 2008) report on family indebtedness. Unsurprisingly, statistics from 2008 record that New Zealanders are personally indebted for staggering sums. In 2008, we owed $152 billion to banks and $12 billion to other lenders. Predictably, in the context of those debt figures and the recession, debt has been a focus in Family Court.

Debt classification – sections 20(1) and (2) of the *Property (Relationships) Act* 1976

The case of *R v R* (9 December 2008, Family Court, Hamilton FAM 2006-019-1018, Judge Riddell) concerned the husband's dental practice, which had been transferred to a trust.

The disputed debt was tax debt owed by the dental practice totalling $335,019.75, as at 30 September 2008. It was incurred both during the relationship and after separation. The wife argued that any tax liability should be the personal debt of the husband, or alternatively that she should only be liable for tax obligations up to the date of separation. The husband argued it was relationship debt. Judge Riddell classified the IRD debt as one incurred in the course of a "common enterprise". Why?

The Judge's focus in classifying this debt as "common enterprise" was the income from the practice as the family income. The wife's participation in the practice was noted. The evidence of her participation is minimal. The dental practice's legal structures excluded the wife almost entirely from the enterprise after 1995. How was this a common enterprise?

The Judge regarded as significant that the tax dispute was protracted and ongoing during the relationship and was litigated as a "test case" by IRD. The husband had taken appropriate advice from professionals, and sought to not be held liable. He was protecting family income by litigation. On that basis, the Judge regarded "the IRD debt [as being] incurred in the course of a common enterprise".

In *B v B* (13 July 2006, Family Court, Christchurch FAM 2004-009-3656, Judge Strettell), the disputed debt was a couple's gambling debt amounting to $17,000. The husband sought to have this debt classified as the wife's personal debt by suggesting it was her gambling issue, as her total personal expenditure of the $17,000 was $13,700.

Judge Strettell classified the debt as incurred in the course of a "common enterprise". The Judge decided that a common enterprise could include the joint pursuit of gambling, as there was clear evidence that both the husband and wife enjoyed gambling as a regular occurrence. "I see nothing in the definition of 'common enterprise' which limits the words to one of a business nature... Here both agreed to undertake gambling as a form of entertainment and as such it was a common enterprise..."

For the purpose of acquiring, improving or maintaining relationship property

Section 20(1)(c) of the *Property (Relationships) Act* has generated the greatest number of cases which consider the debts that can be classified as being relationship debt.

B v B (1 December 2008, High Court, Auckland CIV 2008-404-003848, Justice John Hansen) was an appeal from the decision of the Family Court – a decision of Judge Walker. Due to delay, the appeal was subject to an application for leave to appeal, which was considered by Justice John Hansen in tandem with the issues on appeal.

Judge Walker decided at first instance that the debt at issue – a loan from Mr B's mother – was relationship debt. "Mr B originally acquired the loan for the purposes of obtaining a home and there was agreement it could be used for subsequent properties ... because the Stirling Street home, in which the parties lived, was relationship property, the debt owing to the mother was the relationship debt... [N]o demand had been made for the return of the money so it remained outstanding." The appeal included the status of this debt.

The Court at first instance accepted that the terms of the mother's loan to her son contemplated the debt being used in the future upon resale. The loan was first incurred for pre-relationship, separate property housing. The loan was later used for relationship property – the family home at Stirling Street.

The debt remained, and the purpose remained to purchase housing. But the immediate purpose of the loan was not to buy relationship property. The first-acquired property retained its separate status and did not become relationship property.

Under section 20(2), the property for which the debt was incurred does not need to be relationship property, as long as the property later becomes relationship property. How much later qualifies?

Ms Hollings submitted that section 20(2) contemplated a situation where debt was incurred when acquiring property prior to the relationship and that same property then becoming relationship property. This was not the case on the facts. The debt must be personal and non-deductible.

Justice John Hansen gave no reasons, but indicated that "on the merits, the appeal does not seem to me to be strong" (at [47]). Further reasons were not given.

In *Gendall v Baker* (1 December 2004, Family Court, New Plymouth FAM 2002-043-000245, Judge Murfitt), the disputed debt was a GST liability of $11,420.27 – incurred after the parties separated. The GST debt was associated with "Best Electrical", a business operated as a partnership during the relationship, and which the Judge regarded as a common enterprise between Mr Baker and Ms Gendall. The GST debt accumulated after separation. Judge Murfitt classified the GST debt as relationship debt pursuant to section 20(1)(c). Why?

Mr Baker had made significantly greater post-separation contributions from his post-separation income to sustain mortgages over the family home and rental property until they were sold. By committing his income to that, "he was effectively withdrawing from the business money which should have been retained to pay GST liability" (at [32]). The debt was incurred in the course of maintaining the relationship property – relationship debt.

In *Flasdick v Weastell* (17 June 2005, Family Court, Dunedin FAM 2002-12-721, Judge Smith), the disputed debt was a $5,000 parental loan made by the wife's parents to her solely, prior to the relationship. The loan was recorded in writing, after separation. The parents did not demand repayment. The wife's debt was an advance for a deposit for a house prior to the relationship. Upon entering the relationship, the parties lived there for a short time. That house was disposed of, with proceeds being put into other properties the parties purchased and lived in.

The claim for the debt being relationship was pursuant to section 20(1)(c). The husband argued any parental debt was a personal debt. The reason: the property no longer existed, therefore, the debt could not be considered a relationship debt at the date of separation.

Counsel argued that the debt was relationship as the equity from the first property existed in the other properties which were family homes. Further, the effect of section 20(2) did not require the relationship property for which the debt was incurred to still to be in existence from the date of separation. It only required the debt to still exist. Judge Smith, in interpreting section 20(2), agreed.

In *E v E* [2005] NZFLR 313, the disputed debt was a parental loan of £10,500. The husband sought to have the loan classified as relationship debt, and the wife argued it was personal debt. In 1989, the husband's parents lent him money to fund home alterations – for the purpose of acquiring and/or improving property. However, these transactions occurred prior to the parties commencing a relationship. The home was the husband's separate property and was located in the UK. The husband thought the loans incurred would be treated as relationship debt because the home was sold during the relationship and the proceeds applied for the benefit of the parties.

"immovable property includes a right over all things which cannot be moved whatever the nature of such rights or interest"

The issue was two-fold. First, did the property later become relationship property? Second, "the debt incurred with his parents was incurred in order to acquire real estate in the United Kingdom. Property of that sort is classified as immoveable for the purposes of section 7 of the [*Property (Relationships) Act*]." The debt remained personal as a foreign immovable.

In *R v R* (31 October, Family Court, Hamilton FAM 2004-019-1345, Judge Riddell), the disputed debt was an advance of £48,500 raised by the husband on UK property owned in his sole name to assist with the purchase of a family home in New Zealand. The husband had purchased a property in the UK – a rental property in his sole name. The husband sought to have the sum of £48,500 classified as relationship debt as it was "severable and therefore a moveable" debt. The wife argued the property was a foreign immovable and as such the Courts did not have jurisdiction over it to classify the asset and the debts. Judge Riddell indicated "immovable property includes a right over all things which cannot be moved whatever the nature of such rights or interest". As such, funds secured against the UK property could not be severable from that property and were personal debt.

Personal debt satisfied from relationship property – section 20E

Webster v Webster (18 April 2007, Family Court, New Plymouth FAM 2004-043-891, Judge Murfitt) concerned $38,105 of relationship funds from a joint account that were used by the wife in the two and a half years post separation, mostly on an extravagant post-separation spending spree. She purchased soft toys and other paraphernalia at The Warehouse, SaveMart, 2 Dollar Shop, and other second-hand shops.

Judge Murfitt had little difficulty ordering compensation of $25,403 from the pool of relationship property which equated to two-thirds of that expenditure (the extent of the wife's personal debts incurred after separation which were net from relationship property).

The Judge noted (at [43]) there was no time limit within section 20E of the *Property (Relationships) Act* as to when personal debt was incurred. "It may be incurred post-separation, during the relationship or even prior to the relationship."

When Insolvency Occurs

Minimise the business and economic risk for Companies in stress. Consult with those who have the knowledge, experience and understanding necessary to facilitate the process, optimise recovery and, where possible, rehabilitate the business.

Bryan Williams & Associates are technicians of Insolvency Law specialising in:

- Schemes of Arrangement
- Composition of Creditors
- Voluntary Administration
- Receiverships
- Liquidations
- Voluntary Liquidations for solvent Companies

Williams on Insolvency Issues #9

The Role of Voluntary Administration

Business interests have as an expectation that Insolvency Practitioners are capable of business reconstruction and rehabilitation. However the aspiration of the business owner to achieve the restoration, and the ability to perform that function are frequently worlds apart. The outcome is made difficult, if not impossible, by the delay associated with the engagement.

There is no easy solution to this situation. From the camp of the business owner exists a strong desire to retain power and control until all perceivable opportunities for survival are fully exploited. Within the other camp however exists the need to gain control of the business interests before all resources are so depleted or so fractured that they are valueless. If time and resources permit, the Practitioner with the skill required to implement them, can give effect to the full range of legal methods contained in the tool kit of restorative measures.

The object of the recently adopted Voluntary Administration regime is to recover business value where ever possible. Australian statistics however reveal that more often than not the initiation of Voluntary Administration is just a step toward liquidation. For an alternative outcome to occur, the debtor in possession needs to see a benefit in the engagement and commence that relationship at a time when value can be added.

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