



Debt-dominant division



By Maria Kazmierow, barrister

The economic boom times of the last several years have ended in recession. Consumers face a "credit crunch", with New Zealanders "drowning in debt". Recently, *The Herald on Sunday* stated, "[D]ebt collection agencies report up to a 500 per cent increase in workload over the past few months" ("Bad debts up 500 per cent as easy credit bites", 25 May 2008). Overwhelming debt seems the reality of many families today.

As family lawyers, the likelihood of relationships faltering under the burden of debt and recession may bring a different focus to our relationship property practices, whether the property pool is modest or significant. We may increasingly be asked to advise on property pools that are deficits.

That raises the issue of jurisdiction under the *Property (Relationships) Act 1976* (Act). The traditional interpretation of the Act is that deficits cannot be divided. This has been challenged in a recent decision of Judge Somerville in the Christchurch Family Court.

Orthodox view: deficits cannot be divided

The Act is a code determining the classification and division of relationship property. Section 20 of the Act represents an exclusive code for the deductibility of debts. In particular, section 20D, "Calculation of net value of relationship property", provides:

"The value of the relationship property that may be divided between spouses or partners under this Act must be calculated by—
(a) ascertaining the total value of the relationship property; and then
(b) deducting from that total any secured or unsecured relationship debts owed by either or both spouses or partners."

Interpretation of this section is problematic for clients whose property pool is negative. *Fisher on Matrimonial and Relationship Property* takes a literal interpretation of the wording of section 20D: "If parties have no positive relationship property but are in an overall state of indebtedness, the court has no jurisdiction under section 20 to declare whether debts are personal or relationship ones, and likewise has no power to recompense one party for the other's personal debts" (at 15.4).

If the quantum of debts potentially classifiable as relationship debts outweighs relationship property, then there is no 'net value' of relationship property. Property is a positive value, not a negative one. There is no jurisdiction for division, let alone classification. Families have no recourse to the Family Court to classify and divide their property pool.

This 'orthodox interpretation' arises from three cases. Two are from the Family Court and come from Judge Whitehead. The third is a High Court decision of Justice John Hansen.

Green v Green

Green v Green [1994] NZFLR 423 deals with the Act's predecessor, the *Matrimonial Property Act 1976*, section 20(5). The debt was approximately \$21,336, and largely non-personal debt. The only matrimonial property was \$655. There was negative equity. In a brief decision, Judge Whitehead found at 426 that "if there is no matrimonial property from which any debt can be deducted, there can be no requirement to determine whether debt is personal or not".

A decade later, after the passage of the Act, his Honour had the opportunity to determine whether law reform had made a difference to the way the Court dealt with debt-dominant division.

Eves v Eves

In *Eves v Eves* (2004) 23 FRNZ 1048, the relationship debt was \$46,000, with assets of \$19,000. The property pool was a deficit, totalling \$27,000. Submissions were made that the passage of the Act had altered matters radically in relation to debt-dominant division.

Arguments for the division of a deficit were framed in terms of the purpose of the Act being a reform of the law (section 1N(e)), with the guiding principles in section 1N of the Act including just division of relationship property, having regard to both economic advantages and disadvantages of the relationship. This was then extended by reference to the definition of property in section 2 (including any debt – section 2(d)): "[A]s the Act operates as a code and 'speaks' in all cases involving proceedings between spouses, it would be grossly unjust if one party was left holding all the debt and unable to join the other or recover by virtue of the lack of relationship property".

However, Judge Whitehead again held there was no jurisdiction for the Court to order division, as there was "negative equity" at separation.

Two years later, Justice Hansen considered the same issues, obiter dictum.

G v G

The issue of section 20D jurisdiction was tentative in *G v G* (4 August 2006, High Court, Wellington CIV 2005-485-001676, Justice John Hansen), as there was uncertainty about whether there was negative equity for division. There was a probability that his Honour's findings on tax issues would place the relationship property into positive territory. Section 20D issues were peripheral.

Helpfully, Justice Hansen made the observation that went beyond that of the two previous Family Court decisions: "The only way of determining whether or not there is a positive or negative value of relationship property is to classify it. ... [Section] 20D ... cannot prevent the Court from having the jurisdiction to determine classification... the starting point has got to be the determination of the status/classification, and then its value..."

Current view: equal sharing of economic disadvantage

In 2007, the orthodox view of section 20D was challenged in the Christchurch Family Court by Judge Somerville. The case, *C v W* [*Relationship Property*] [2007] NZFLR 1132, signals a principled approach to the issue of debt-dominant division.

In a case typical of the debt-deficit cases presenting in the Family Court, the debt levels in this case were not high. However, the level of polarisation between the parties was. Judge Somerville commented at [1], "Seldom does one see such keenly fought property proceedings involving so little property".

The relationship property amounted to assets of \$15,571 and debts of \$22,356, with a deficit of \$6,785. Polarised parties of limited means clearly do require the assistance of the Court to determine the division of the property pool. After determining the classification and value of all relationship property and relationship debt, it was clear this was a negative equity case. Judge Somerville took a radically different approach to the division of deficit, justifying this by refocusing on principle.

G v G presented his Honour no difficulty, as the negative equity issue had not been fully argued, both counsel having conceded the point, making it unnecessary for the Judge to make a ruling on the issue. There was also a likelihood that positive property would exist, making the section 20D jurisdiction issue theoretical.

In *C v W*, his Honour examined why section 20D had been interpreted as it had by the Family Court. In his view, there were two factors which made the Court's previous approach incorrect: drafting errors in the Act, and the Act's aims and law reform represented by the Act.

Statutory drafting error

In Judge Somerville's view, there is a "circular reference" to "relationship property" in section 20D. "The draftsman is merely making the rather obvious statement that the [section] 20 debts must be taken into account when dividing the parties' property, and that this is to be done on a global basis rather than individually in respect of each

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asset," his Honour said at [73]. The specific error was the duplication of "relationship property". The section only made sense by eliminating the "net value relationship property", and substituting "the net value of what is to be divided".

ERROR: The net value of *relationship property* is calculated by deducting relationship debt from the total value of *relationship property*.

CORRECT: The net value of *what is to be divided* is calculated by deducting relationship debt from the total value of *relationship property*.

His Honour showed the drafting error mathematically via a simple equation, showing the invalidity of the literal equation in section 20D, with A equalling section 8 property, B equalling section 2 debts, and P equalling the value of what is to be divided.

Orthodox interpretation of section 20D

$$A = A - B$$

$$100 = 100 - 50$$

Judge Somerville interpretation of section 20D

$$P = A - B$$

$$50 = 100 - 50$$

His Honour noted at [74] that this was not an isolated error in the Act: "[T]he draftsman has fallen into the trap of occasionally using the expression "relationship property" in a wider sense than simply "[section] 8 property". Examples include: section 1M1(c); section 1N(c); section 1N(d); section 4(4); section 7A(2); section 18A(3); and section 18C(2).

In defining net value, his Honour opined at [75] that "better sense can be made of this section if "relationship property" is extended beyond the limited definition in [section] 2, to mean, in this case, the complete bundle of property rights and obligations enjoyed by the parties."

Principle and law reform

In Judge Somerville's view, if section 20D read as the "net value of what is to be divided", a valid answer can be obtained, even if the value of P is negative. This would be in keeping with the purpose and law reform aspect of the Act (at [77]):

"If the parties have incurred debt during the relationship that exceeds the value of the assets acquired during the period, a just outcome would be for them to share equally in this economic disadvantage. Conversely, it would be unjust for one of the parties to bear a disproportionate share of the loss. Indeed, there would be a serious injustice if the Court were powerless to provide relief where one of the parties retained all the assets and the other all the debts, simply because the value of debt was greater than the value of the assets."

The result of no relief is also unjust (at [82]): "If the imbalance in the [section] 8 property is raised in ... civil proceedings, [section] 4(4) of the [Act] dictates that the issues must be decided as if it had been raised under that Act, which brings us back to where we started."

Deficit division: where to from here?

The approach of *C v W* at first instance has yet to be considered in substantive proceedings. When contacted, counsel stated that the decision of Judge Somerville will not be appealed.

The only consideration of *C v W* thus far was a reference to the decision in *KAH v RPMD & RWF* (23 November 2007, Family Court, North Shore FAM 2003-084-33), a decision of Judge Ryan. He approvingly considered Judge Somerville's approach when contemplating an order for payment, even though there might not have been relationship property from which that payment could be made (at [9]).

Fisher has yet to provide a considered response to the judgment. When contacted, Professor Atkin, author of chapter 15, "Debt", agreed to respond prior to a substantive updating of *Fisher*. He disagrees with *C v W*. However, he supports the justice and fairness aspects of the decision, believing law reform is the more appropriate way to deal with the negative equity issue.

Currently, the jurisdictional gate has opened for debt-dominant division. Whether it stays open remains to be seen.

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