RELATIONSHIP PROPERTY – SHOULD NEW ZEALAND'S REGIME BE MANDATORY OR OPTIONAL?

Paper by Hon Robert Fisher QC for Colloquium on the Property (Relationships) Act 1976, University of Otago, Auckland Centre, 9 December 2016

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Introduction

The subject of contracting out begins with the regime that would otherwise apply. Only with a proper understanding of that regime can one decide whether the grass in the other paddock would be greener.

The default regime in New Zealand is currently the Property (Relationships) Act 1976 (**the PRA)**. The PRA was an inspired social ideal compromised by its inept execution. The inept execution is the principal reason that so many couples presently need to contract out.

There is now an opportunity to substitute a statutory regime which is not merely enlightened in its social goals but goes on to achieve them on a sound technical footing. That will require a reform which is courageous, imaginative and fundamental. Sadly, we will need to sacrifice our investment in a very large body of authorities. However they are authorities encrusted onto a flawed framework. The reward of a new regime is that if we go about it in the right way it will be more simple and logical to apply. It will also remove the need to contract out.

Rationales for redistributing assets on separation

Relationship property law is mainly about the way in which a couple's assets are redistributed on separation. For the reformer, many other important issues need be resolved along the way. These include the kind of regime (unitary, separate, full or deferred community), the way in which the regime is applied (rule-based or discretionary), the relationship between the regime and spousal support (integrated or distinct) and the couple's relationship with creditors (enforcement against either or both and on what basis). But the topic of real interest to most couples is simply how much each will get if they separate. As that is what drives contracting out, it is the focus of this paper.

The inquiry into how much each will get begins with the rationales for redistributing assets on separation. Knowing why assets should be redistributed is important for law reformers and parties alike. If reformers can predict what the majority of couples want, they should be able to put it into the legislation to begin with. Contracting out is the result of a mismatch between a couple's expectations and what they find in the legislation.

What do most couples want? Individuals within a relationship may want different things. But contracting out, as well as democratically determined social policy, must be built on consensus. Most New Zealanders share instinctive expectations over the fate of a couple's assets if they separate. The expectations stem from the underlying rationales for dividing property. Despite the flood of relationship property decisions and commentary, surprisingly little is said about the underlying reasons for dividing property in the way we do.

Underneath it all there appear to be three contemporary rationales for redistributing assets on separation:

(a) To give each party a share in those assets which each, in his or her own way, helped to create during the relationship ("causation-based property division");

(b) To compensate a party for a disparity in earning capacity caused by the division of functions within the relationship ("relationship-caused disparity in earning capacity"); and

(c) To meet one party's obligation to provide the other with spousal support ("spousal support obligations").

These will be considered in turn.

(a) Causation-based property division

Whatever views might have been held in New Zealand in the past, it is now generally accepted that the assets which each party takes away from a relationship should reflect the fact that during the relationship each had played a vital role in their acquisition. For this purpose the relationship can be viewed as a form of partnership. Over the course of the relationship the various earnings and efforts of the parties normally cause a growth in the partnership capital. The growth is achieved through creating, acquiring or improving assets or reducing partnership debt.

This partnership-caused capital, sometimes referred to as the fruits of the relationship ("FOR") owes its existence to the joint and several efforts of both.[1] The concept has its roots in causation. While the homemaker's contribution is more indirect, it frees the breadwinner from those domestic burdens which the breadwinner would otherwise have to perform in person. In that way both cause the accumulation of capital.

Once that causative principle is recognised, the second step is to quantify the value of each party's contribution. It is also now generally accepted that in the acquisition of capital, the homemaker's contribution is inherently equal to that of the breadwinner. And even where, as is increasingly the norm, both were breadwinners for all or part of the time they were together, the party with the higher earnings tends to finish up with legal title to a greater proportion of their assets before they are redistributed. For that reason many regimes, including the PRA, are built on the premise that each party plays an equal part in accumulating FOR and that in consequence each should receive an equal share of the FOR when the relationship ends.

In principle it would be possible for a regime to permit one party to rebut the presumption of equality of contribution by proving that in the particular case his or her contribution to the relationship – whether financial or domestic - was greater than that of the other.[2] However the simplicity and certainty offered by strict equal sharing might be thought to outweigh the potential justice of comparing the value of the contributions actually made. Strict equality

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[1] New Zealand lawyers are used to the expressions "relationship property" and "separate property" to distinguish between divisible and non-divisible property under the PRA. Given the Act's confusion over the reasons for the distinction, it was thought better to start again with "fruits of the relationship" (FOR) and "externally sourced assets" (ESA) in this paper.

[2] As was the case in New Zealand during the 14 years between the enactment of the PRA in 1976 and reform of that aspect by the PRA Amendment Act 2001.

also avoids the invidious spectacle of an inquiry into the history of each party's conduct during the relationship. The majority of modern regimes therefore support the principle that FOR should be divided equally.[3]

The division of FOR is to be distinguished from the treatment of assets which a partner already owned when the relationship began, or which were subsequently acquired through third party gift or inheritance. In this paper it will be convenient to refer to these assets as "externally sourced assets" or "ESA".

The expectation of most people is that on separation FOR will be shared equally and ESA will remain with its original owner. Although Western matrimonial property regimes vary greatly in form, the majority give full or partial effect to those principles, and in particular to the distinction between FOR and ESA.[4] Even in discretionary regimes such as England and Wales, the same binary distinction is now favoured.[5]

(b) Compensation for disparity in earning capacity

The second potential reason for redistributing assets on separation is to compensate for a relationship-caused disparity in earning capacity.[6] During the relationship the breadwinner's career may have followed an upward trajectory while the homemaker's trended downward due to a lengthy period of child-raising and household management. One party may have tolerated a relatively modest income as a shop-attendant so that the other could acquire high-paying qualifications as a surgeon. In cases of this kind the result is likely to be a significant disparity in earning capacity.

The existence and extent of such a disparity is measured at the end of the relationship. The disparity may take the form of an enhancement in one party's earning capacity, a diminution in the other's, or both. In capital terms the extent of the disparity can be measured by comparing the estimated present value of one partner's future earnings stream with the present value of the other's.

If a disparity of that kind is demonstrated, the final step is to establish its cause. There can be no logical basis for compensation if the disparity was due to different levels of skill or qualification attained before the relationship began or to the personal attributes of the parties. However if all or part of the disparity is attributable to the division of functions during the relationship, the disadvantaged party can justifiably look to the other for compensation. The

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[3] For an excellent comparative survey of contracting out agreements see Jens M. Scherpe Ch 17 in Jens M. Scherpe (ed) *Marital Agreements and Private Autonomy in Comparative Perspective* (Hart, 2012) (hereafter "Scherpe, Agreements"). For a European perspective on the various regimes themselves see Jens M. Scherpe Chapter 5 in Jens M Scherpe (ed) *European Family Law* (Edward Elgar) Vol 4.

[4] Scherpe, Agreements, above n 2 at 478.

[5] A Chandler,' "The law is now reasonably clear": the courts' approach to non-matrimonial assets' [2012] Fam Law 163; JM Scherpe, "A Comparative Overview of the Treatment of Non-matrimonial Assets, Indexation and Value Increases" [2013] Child and Family Law Quarterly 61.

[6] Although this is commonly referred to in New Zealand as an "economic disparity" claim that expression is misleading; the concept is confined to relationship-caused disparity in earning capacity.

compensation can take various forms including the award of additional property on separation.

(c) Spousal support obligations

The third potential reason for redistributing assets on separation is spousal support. An award of property ownership or occupation may prove to be the best method of meeting one party's need for personal support in circumstances where the other has an obligation to provide it.

Need implies that the claimant lacks the resources or earning capacity to meet his or her reasonable living requirements[7] but need alone is normally insufficient.[8] Under most modern regimes one separated party has an obligation to support the other only where (i) the claimant's need is due to the ongoing daily care of dependent children of the relationship, (ii) a limited transitional period is required for the claimant to retrain or otherwise adjust to the new circumstances, or (iii) a longer period is justified due to a permanent reduction in earning capacity attributable to the division of functions during the relationship.[9] Those three possibilities require further discussion given their potential impact on the division of property.

(i) Ongoing care of children

The rationale for imposing an obligation to maintain where one party's need stems from the care of dependent children of the relationship is self-evident. A non-custodial parent normally makes a direct financial contribution to the living expenses of the children themselves. But in addition the custodial parent will usually suffer a suspension or reduction in the opportunity to earn due to the diversion of time and effort into the day to day care of the children. As the care of the children is the equal and continuing responsibility of both parents, there is good reason for requiring the non-custodial parent to compensate the other for the cost of discharging that responsibility on his or her behalf.[10]

(ii) Support during adjustment period

The second rationale for imposing a support obligation is that the claimant may require time to adjust to separation given the way in which the parties had organised their affairs during the relationship. Typically the breadwinner has acquiesced in, or positively encouraged, an expectation on the part of the homemaker that he or she will be permanently provided for. If that expectation is unexpectedly withdrawn, the homemaker will need time to retrain or adjust. As the responsibility for creating the need to adjust was a shared one, there is good reason for sharing the cost of a period to retrain and adjust.[11]

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[7] For example in New Zealand see Family Proceedings Act 1980 ("FPA"), s 64(1).
[8] FPA, ss 64(4) and and 64A.
[9] FPA, s 64((2).
[10] PRA s 15(2)(b); FPA, s 64(2)(b).
[11] FPA, s 64(2)(d)

(iii) Support due to reduction in earning capacity

As noted earlier, a relationship-produced disparity in earning capacity provides a rationale for redistributing assets as a form of compensation. It can equally be viewed as a rationale for imposing an ongoing obligation to provide spousal support.[12] If viewed as an ongoing support obligation, the remedy can take one of three different forms: periodical maintenance, capital maintenance or the exclusive possession of the family home or other relationship asset. Each warrants description.

Periodical maintenance. The majority of orders for spousal support in New Zealand have tended to be interim orders for periodical maintenance.[13] One of the special reasons for support just discussed must be established before there will be an award of long term periodical maintenance.

Capital maintenance. Where there are grounds for long term spousal support, and it is financially practicable, maintenance in the form of immediate capital has the advantage of promoting a clean break.[14] Current New Zealand legislation permits maintenance to be paid in the form of a lump sum.[15] We currently lack statutory authority for redistributing specific items of property in whole or partial satisfaction of a spousal support obligation. This may not matter a great deal in practice, however, given that an order to maintain by paying a lump sum provides a measure of value which the parties can readily convert into specific assets if so agreed.

Possession of relationship property. A temporary right to occupy may be a complete or partial alternative to maintenance. The clean break principle suggests a preference for a full and final division of relationship property where practicable. But in some cases the combined value of the parties' assets may be insufficient to provide for the needs of a partner who has an established right to support, especially where the principal asset is the home and it is needed for children of the relationship. In those circumstances support from the absent partner may need to take the form of a right to occupy the home for the custodial parent and children during their dependency.

In New Zealand support in the form of possession or occupation of relationship property is currently provided for in the PRA[16] rather than the legislation where other support matters are to be found.[17] This should not obscure the fact that what is being provided is not a causation-based division of property but support for the custodial parent and children. As a matter of drafting, the basis for the occupation right could have been included in Part 6 of the Family Proceedings Act, and the Child Support Act 1991. That might have promoted a clearer understanding of the distinction between causation-based property division, on the one hand,

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[12] FPA, s 64(2)(a)(ii).
[13] For jurisdiction see FPA s 69.
[14] In New Zealand the principle is that separated partners must assume responsibility for meeting their own needs as soon as is reasonable: FPA, s 64A.
[15] Section 69 of the FPA permits both periodical and lump sum maintenance orders.
[16] Property (Relationships) Act 1976, ss 27, 28, 28A, 28B and 33 and, for children, s 26.
[17] FPA, Part 6.

and the right to support, on the other. But so long as that distinction is clearly maintained, little turns on the legislative vehicle chosen to deliver it.[18]

Relationship between the three rationales for redistributing assets on separation

The three rationales for redistributing assets on separation follow a logical order. The first and primary rationale is that each has earned half the FOR through their direct and indirect contributions during the relationship. Application of that rationale will normally result in each party leaving the relationship with half the FOR, whether in money or specific assets. This causation-based division forms the basis for the primary property regime.

Depending on the circumstances, the other two rationales may or may not warrant modification to the equal sharing that would otherwise result. The second rationale was the need to compensate for any relationship-caused disparity in earning capacity. Such an entitlement would require an increment to that party's half share.

The third rationale was that in some circumstances one party will be entitled to spousal support from the other. Putting aside interim arrangements, this cannot be determined until the result of causation-based property division, and any earnings compensation claim, is known. Only then will it be apparent whether the claimant has been left with a residual need for support. Leaving this determination to last also avoids the duplication that could result from the assessment of a relationship-caused reduction in earning capacity. [19]

The normal limits of property sharing

It follows that the principal rationale for a modern property regime is the causal nexus between the joint and several efforts of the parties during the relationship, on the one hand, and the creation of FOR, on the other. That rationale for sharing FOR could have no application to assets which had come to the parties from sources external to the operations of the partnership.

For that reason one would expect externally-sourced assets (ESA) to be excluded from the process of redistributing assets on separation. The ESA normally comprises pre-relationship property, third party gifts and inheritances. For understandable reasons, other jurisdictions sometimes extend it to damages for pain and suffering. As the partnership had nothing to do with the acquisition of capital from those sources, there is no rationale for dividing it on separation.

A special case for the family home?

The PRA divides the family home in equal shares regardless of source. In the majority of cases no harm is done because the home would be FOR in any event. But a causation

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[18] Note also that as presently drafted, s 32 of the PRA permits the review of maintenance in the context of proceedings under that Act.

[19] Query the necessity for duplicating this consideration in the Family Proceedings Act, s s 64(2)(a)(ii).

rationale for division does not explain how an ESA home could also fall for division.[20] The very fact that the home had come from a source that was external to the operations of the partnership removes the opportunity for a causal nexus between actions of the parties and the acquisition of the home.

Might there some other rationale for including an ESA family home in the property division? None was ever articulated by those responsible for the PRA. One is left to speculate.

One possibility is that the special treatment of family homes was subconsciously associated with spousal support. The non-owner party will understandably wish to stay on in the home to which he or she has grown accustomed, especially if children are involved. For that reason there will often be good reasons for using the family home in full or part satisfaction of the owner's spousal support obligation, if such obligation exists. But the vesting of a half interest in an ESA home, or the grant of a right to occupy it for that purpose, could be remedial only; the substantive basis for the spousal support right would still need to be independently justified on the support principles discussed earlier. The ESA home would not form part of the basket of properties to which the primary regime applied. It could not explain the PRA approach.

Another possibility is that the special treatment of family homes was subconsciously associated with a form of equitable estoppel. Perhaps it was thought that by allowing the non-owner to live in an ESA family home during the relationship, its owner has fostered an expectation in the non-owner that the latter will acquire a half interest in it or be permitted to live there permanently; in reliance on that expectation the non-owner has acted to his or her detriment by diverting elsewhere the funds which would otherwise have been channelled into a home; by acting in that way the non-owner has foregone the opportunity to save for, and jointly invest in, a home and its subsequent increase in value; to allow the owner to retain sole ownership of the home in those circumstances would be unconscionable; and an immediate right to a half interest is the only way of avoiding an unconscionable outcome.[21]

If that had been the reasoning it would be unconvincing. To begin with, it is difficult to see how the free use of another's dwelling could ever justify the expectation that it would result in an immediate half interest. What reasonable person would think that? And even if that had been a reasonable expectation for a person left in the dark, the PRA divides the home regardless of discussions and warnings between the parties. Nor would the theory give any credit for the gratuitous nature of the shared use. A calculating owner would have used the ESA capital as an investment and insisted on some other arrangement for the family home. The fact that the owner has instead permitted its use as the home does not justify appropriation of half its value. A favour twice extended should not become a right.

Neither of those speculative theories could satisfactorily explain why the PRA singles out the family home for special treatment. The real explanation is undoubtedly historical. The home

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[20] In the interests of simplicity family chattels have been ignored but the same reasoning must apply cf PRA, s 8(b).

[21] Assuming, of course, that the relationship has lasted for three years – see PRA, s 14.

was the battleground on which women's property rights were first developed. In New Zealand, as in other common law countries, there was growing concern that the law failed to give adequate recognition to the domestic role of women. The earliest inroads into that problem were made through the home.

The courts developed a range of equitable concepts which strove to give the wife some form of proprietary interest. In that exercise there were several reasons for starting with the home. Intentions imputed to the parties more readily related to the asset with which both were most closely associated.[22] As the home was the property where the wife spent most of her time, it was simplistically assumed that it must be the destination for her indirect contributions to property.[23] If any asset required protection from the husband's creditors, the home was the obvious candidate. In New Zealand these notions received early recognition in the Joint Family Homes Act 1950 and part VIII of the Matrimonial Proceedings Act 1963. At that time half a loaf was better than none.

All of that lies in the past. The home was no more than a Trojan horse into male-dominated property ownership. As soon as the relationship property net was extended to *all* property acquired by the joint and several operations of the partnership, the reason for singling out the home in particular disappeared. There is no longer any need to rationalise a home-maker's interest in property by imputing fictional intentions to the parties. Nor is there any justification for confining the reach of the home-maker's contribution to the home. The causal connection applies to all assets acquired during the relationship. And for protection against creditors, a notice of claim can now be registered against the title to all assets, not merely the home.

The PRA displays a lamentable confusion between two incompatible concepts. One is a forward-looking recognition of the inherently equal contribution of both parties to all wealth-creation during the relationship. The other is a backward-looking retention of jurisdiction based on the home (to which were added other assets that happened to be used by both parties). Certainly the home continues to have special significance when it comes to support for former spouses and children. But support rights must be established on their own discrete principles. If the primary property regime is to be founded upon the causes of wealth-creation, homes are no different from any other kind of property. Of all the anomalies in the PRA, this is the greatest. It has also proved to be the most popular reason for contracting out.

The philosophical approach to property acquired for common use or benefit

Similar reasoning applies to any other class of property acquired for the common use or common benefit of both parties.[24]

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[22] *Rimmer v Rimmer* [1952] 2 All ER 863; *Bendall v McWhirter* [1952] 1 All ER 1307; *Masters v Masters* [1954] NZLR 82; *Reeves v Reeves* [1958] NZLR 3176; *Gissing v Gissing* [1971] AC 886 (HL); *Cowcher v Cowcher* [1972] 1 All ER 943.

[23] *Hendry v Hendry* [1960] NZLR 48; *Efstratiou v Glantschnig* [1972] NZLR 594.

[24] PRA, s 8(d) and (ee).

Of course in most cases property acquired for common use or common benefit will qualify as FOR and therefore be subject to equal division on that basis. But in cases where the asset in question is ESA, it is difficult to find any rational basis for treating it as divisible relationship property. By definition, one of the parties must have owned the ESA before the relationship or acquired it subsequently by third party gift or inheritance. It can be taken, therefore, that it does not owe its existence to any relevant act, direct or indirect, of the parties.

As with homes, the owner of the ESA capital in question could have invested it, thereby placing it beyond the reach of the other party. The fact that the owner has instead chosen to share its use by acquiring an asset such as a holiday home is no reason for taking half away and handing it to the other party. Yet that is the effect of the PRA as it presently stands.[25] It is an added reason for contracting out.

The philosophical approach to tracing FOR and ESA capital

Capital is fungible in the sense that it is freely exchangeable between cash, bank account credits, investments and other forms of property, without changing its essential character for present purposes. So in a commercial partnership it is taken for granted that, as between the partners, earned or contributed funds retain their original character regardless of the various forms through which they might pass. The income earned by partnership operations (the equivalent of FOR) does not cease to be credited in the books as partnership income merely because it is banked, used to buy office furniture, or paid out to one partner as drawings. The same is true of equity contributions by the partners derived from sources personal to that partner (the equivalent of ESA).

There is no discernible reason for treating family relationships differently. Funds accumulated from earnings and other forms of personal effort are FOR. Funds owned before the relationship began, or received by third party gifts or inheritance during the relationship, are ESA. The capital they represent does not relevantly change its character merely because it passes through the purchase and resale of a succession of properties, is used as the working capital of a business, or is mixed in a common fund. Nor does the fact that funds from both sources have been intermingled prevent an estimation of the relative proportions of FOR and ESA. Tracing is scarcely a novel legal concept even where robust estimation may be called for in place of precise calculation.

The concept of tracing can be readily applied to increases in value for relationship property purposes. Without more, one would expect an increase in the value of an asset to attract the same FOR/ESA classification as the original asset. Thus an increase in the value of a FOR house due to a spontaneous rise in real estate values will attract the same FOR classification. The same is true of inherited shares (ESA). If the share value rises during the relationship, one would expect the increase to be classified as ESA unless there were special reasons for thinking otherwise.

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[25] PRA, *ibid*.

There are special reasons for thinking otherwise where an increase in the value of an ESA is attributable to partnership efforts or the injection of FOR. If a couple have used their FOR earnings to add a haybarn to the husband's ESA inherited farm, one would expect a corresponding proportion of the farm's increase in value to be treated as FOR. One would expect the same to be true if the increase in the value of the ESA farm was due to the labour of either or both of the parties.[26] Anything created by labour during the relationship must be FOR because it owes its existence to the operations of the partnership. Of course this does not extend to spontaneous increases in value attributable to inflation or rises in the value of property of that type. So if an increase is partly spontaneous, and partly due to the injection of FOR, an appropriate apportionment is required between the two causes of the increase in value.

The same reasoning applies in reverse where ESA (such as a legacy) has been used to pay for an improvement to a FOR asset (such as a jointly purchased house). In those circumstances one would expect the original owner of the ESA (the party who had inherited the funds) to have a claim on an appropriate proportion of the house, including a proportion of any increase in its value, before equal division of the balance.

Perhaps those responsible for the PRA thought that tracing capital in this way would be impractical. Certainly one would not expect a couple to retain sufficient records to permit apportionment between two streams of capital on any precise or calculated basis. But the law has never shrunk from broad and robust estimates. Estimates are based on such evidence as may be available, however slender. The assessment of damages at common law is a good example. So is the extent to which spousal efforts during a relationship have contributed to an increase in value.

When it comes to tracing FOR and ESA capital, it is a mistake to try to prescribe detailed rules, such as the present conversion of the whole of an increase in the value of an ESA asset if any part of the increase had been attributable to the injection of FOR capital,[27] or the conversion of inherited property (but not pre-relationship property!) to relationship property if inextricably intermingled.[28] The PRA's bungled attempt to prescribe detailed rules on topics like this has proved a hindrance rather than a help. Far better to return to the concept that underlies the regime as a whole: FOR is to be divided and ESA retained. Where FOR and ESA funds have been channeled into the same asset, the extent to which each contributed to the ultimate value of the asset can be estimated and the total apportioned accordingly. Valuers routinely undertake assessments of that kind.

All of this illustrates something which is conceptually simple: for relationship property purposes FOR and ESA capital should retain its essential character regardless of the various forms through which it might pass. No reason has been identified for any other approach.

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[26] Note the further anomaly that under s 9A(2) of the PRA only actions of the *non-owner* qualify as a relevant contribution to the increase in value of the separate property. Why not actions of the owner as well?
[27] PRA s 9A(1).
[28] PRA, s 10(1).

Although some attempt was made to implement that principle in the PRA, it failed in critical areas. Probably the most serious is the way in which the whole of an increase in the value of an ESA property is converted to divisible relationship property if any part of the increase was attributable to the application of relationship property.[29] This might sound a technical detail but in practice it has had a huge impact on the treatment of farms and other long term ESA assets. It was inevitable that over a long period inflation would multiply their value many times over. It was also likely that at some point FOR would find its way into an improvement to the property. A barn or a delivery van would be paid for from the couple's earnings. By that means the entire increase in the value of an ESA farm or business would be converted to divisible relationship property. This provided another major reason for contracting out.

What happened in New Zealand?

In earlier years New Zealand's matrimonial property laws evolved in tandem with other Commonwealth countries. Broadly speaking English matrimonial property law moved from a unitary regime to one of separate property onto which a series of equitable remedies were engrafted.[30]

The Matrimonial Property Act 1963 ("the 1963 Act")[31] ushered in a new regime. It permitted the Courts to redistribute assets on a discretionary basis akin to the discretions which continue to operate in England and Australia today. Under the 1963 Act a Judge could "make such order as he thinks fit with respect to the property in dispute". In doing so the Judge was to have regard to "the respective contributions of the husband and wife to the property in dispute (whether in the form of money payments, services, prudent management, or otherwise howsoever)".

In 1969 the New Zealand Law Society asked the Minister of Justice to consider the impact of insolvency on matrimonial property rights. The Minister added other issues to consider. The resultant committee of two legal practitioners and two officers from the Department of Justice produced a 26 page report in 1972.[32] The report eschewed any attempt to examine comparative law on the subject[33] but pointed out that awards for wives were inadequate. The inadequacy was due to an unfortunate Court of Appeal perception at that time that claimants had to be able to trace specific contributions to specific items of property.[34]

The Committee rightly pointed out that contributions to the marriage partnership needed to be applied globally to the assets of the marriage as a whole.[35] Without examining why, they

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[29] PRA, s 9A(1).

[30] For a detailed history see *Fisher on Matrimonial and Relationship Property* (LexisNexis 2016) paras 1.4 to 1.18.

[31] And similar powers in Part VIII of the Matrimonial Proceedings Act 1963.

[32] *Matrimonial Property Report of a Special Committee* presented to the Minister of Justice June 1972

[33] *Matrimonial Property Report* at para 4.

[34] *E v E* [1971] NZLR 859 (CA).

[35] Ironically, the problems created by *E v E* were largely cured by the Privy Council decision in *Haldane v Haldane* [1976] NZLR 715 but by then statutory reform had gathered momentum

went on to recommend that the matrimonial home, property acquired in contemplation of marriage, and accretions to the value of pre-relationship assets, should all be treated as "assets of the marriage" regardless of origin. The Committee's report was handed to the Department of Justice to implement.

After three years of unpublished work by the Department, the Government of the day introduced the Matrimonial Property Bill 1975. The accompanying White Paper identified five problems with the 1963 Act:[36]

> (i) The applicant, usually the wife, had the onus of proving specific contributions to property;
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> (ii) The breadth of the judicial discretion led to uncertainty;
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> (iii) Awards to wives tended to be less than generous, with wives sometimes receiving no more than a one-quarter or one-third share in the matrimonial home after many years of hard work;
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> (iv) Contributions had to be traced to specific items of property; and
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> (v) There was an unsatisfactory overlap between the two 1963 Acts.

Ironically, many of these difficulties were remedied by the Privy Council decision in *Haldane*.[3] The Privy Council restored a global approach to the tracing of contributions to FOR capital. However by this stage the Bill had gained momentum. The White Paper went on to say:

> The definition- of matrimonial property has proved complex, but its concept is simple. It comprises broadly the matrimonial home, the family chattels (including such amenities as a car or a boat), and all other property acquired by husband or wife after the marriage except by inheritance or gift.

The rationale for that approach was nowhere explained. Nor was any reason offered for the ways in which the Bill now converted ESA to divisible matrimonial property. After minor adjustments the Bill was enacted as the PRA.

The PRA

For understandable reasons those responsible for the PRA preferred a rule-based regime to a discretionary one; conventional separate property principles unless and until a couple separated; and strict or presumptive equal division of matrimonial property if they did. These choices appeared to point New Zealand in the direction of one of the many overseas community of surplus regimes which could have been adopted, with or without minor modification.

Instead, the PRA went off in a novel and startling direction. In place of broad principles to distinguish between FOR and ESA, it attempted to identify particular types of asset or

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[36] Matrimonial Property - Comparable Sharing, An Explanation of the Matrimonial Property Bill 1975" [1975] AJHR E6.

liability to which prescriptive rules would apply. Thus the matrimonial home, household articles, household ornaments (including artworks no matter how valuable), tools, motor vehicles, caravans and boats were singled out for strict equal division.[37]

A second collection of asset-types were bundled together for division which was to be equal unless either could show unequal contributions to the marriage partnership.[38] This category included not only wealth accumulated by the efforts of either or both parties during the marriage[39] - as one would expect - but much other property besides. It captured property acquired before or during the marriage for common use and benefit[40] and (originally) the whole of a life insurance policy or superannuation benefit unless fully paid up before marriage.[41] Also captured in the second category was capital acquired by gift, inheritance or trust if inextricably intermingled with other matrimonial property and, in certain circumstances, inflationary increases in value. As originally enacted,[42] if any part of an increase in the value of separate property could be attributed to the actions of the non-owner, or to the application of matrimonial property, the whole of the increase in value was to be treated as matrimonial property. The fact that by far the greater part of the increase was usually due to inflation was ignored.

In a third category were those residual ESA assets that remained after application of the rules that appropriated property for the first and second categories. The third category assets remained the separate property of the owner.

The result was a regime of great intricacy. It also had the unfortunate result of scooping into the divisible matrimonial property much capital which had owed its existence to factors that had nothing to do with the marriage partnership. Although some of the anomalies have since been addressed in amendments,[43] the great majority remain. Much of the Act still ignores the distinction between FOR and ESA.

The flight to alternatives

A couple usually expect to share the wealth they create during their relationship; they are less impressed by the idea that they should also have to share the property which they already had before the relationship began, or which they acquire subsequently from their parents by gift or inheritance. The parents themselves will be even less impressed. They may be happy to give or bequeath property to their child, and for the child's partner to share in its use and

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[37] PRA, ss 8(a) and (b) and 11(1)(a) and (b).
[38] PRA, s 15, prior to its later replacement by strict equal division in 2001.
[39] PRA, ss 8(e).
[40] PRA, s 8(d) and (e).
[41] PRA, s 8(g) and (i), also amended later in 2001.
[42] PRA, s 9(3).
[43] Notably the Property (Relationships) Amendment Act 2001 which removed the increase in value anomaly where based on contributory actions of the non-owner but, inexplicably, retained the anomaly for contributory applications of relationship property (see now s 9A). Under the same amending Act, life insurance policies and superannuation entitlements became subject to apportionment in accordance with pre-relationship and post-relationship contributions.

enjoyment while they remain together. They usually resist the idea that half their child's gift or inheritance is vulnerable if the couple separates.

Those problems may be countered in one of three ways.

One is to deliberately keep ESA capital away from the shared life of the couple. One party to a relationship may choose to separately invest ESA funds in his or her own name rather than employ them in a shared amenity such as a holiday home. But a choice of that kind presupposes either legal advice or a sophisticated understanding of the PRA. It is also an unwelcome intrusion into what ought to be a relationship of cooperation and pooling of resources.

Secondly one party, or more usually that party's parents, may settle the ESA on a family trust of which the child is merely a discretionary beneficiary. Trust practitioners always cite this as one of the principal reasons for settling a trust. It goes a long way towards explaining the abnormally high number of family trusts in New Zealand.[44] Attempts to use trusts as a shield behind which FOR can be hidden are rightly ineffective. However even for ESA, they are not foolproof. There may or may not be other reasons for settling family trusts but those presently prompted by the PRA would be unnecessary if the primary regime drew a proper distinction between FOR and ESA.

Thirdly, the couple can take refuge in a contracting out agreement. Contracting out agreements are particularly common where one party starts out with a major asset (usually a home, farm or business) or the relationship in contemplation is a second marriage (where the parties usually combine an inequality of assets with a wariness derived from experience). In either case a regime which respected the distinction between FOR and ESA would make such agreements unnecessary.

Judicial recognition of the FOR/ESA distinction

The jurisdiction to uphold or set aside contracting out agreements gave judges the opportunity to show whether or not they were in sympathy with the PRA's approach to FOR and ESA. The Courts can set aside contracting out agreements which would result in serious injustice.[45] While many factors can affect the possibility of serious injustice, the significant one for present purpose has been the approach taken to FOR and ESA.

Judges tend to set aside contracting out agreements as unreasonable if they purport to preserve all or part of the FOR for one spouse alone. Typical was the setting aside of an agreement which would have given the wife only $30,000 in return for forfeiting the right to share in future increases in the value of her husband's substantial businesses.[46] The rejected agreement would have flouted the modern philosophy that the homemaker's indirect contribution is inherently equal to that of the breadwinner. The agreement did not share FOR.

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[44] Estimated by the Law Commission to be 250,000 compared with a total population of about 4.5 million [citation needed].

[45] PRA s 21J.

[46] *Clayton v Clayton* [2013] NZHC 301

Most significant, however, have been the cases in which judges have upheld agreements even where their purpose was to negate the PRA treatment of ESA as divisible relationship property. Most of these agreements were designed to preserve sole ownership of ESA dwellings if the owners agreed to their use as family homes. Others were designed to preserve other forms of ESA.

Accordingly agreements have been upheld where they preserved a pre-marriage ESA dwelling for its owner despite its subsequent use as the family home;[47] or preserved for the wife alone an ESA house which, although in the name of both spouses, had been purchased with funds gifted by her parents alone;[48] or which preserved for the husband alone an ESA home which he had owned before the relationship began;[49] or which preserved for the husband alone all his ESA pre-marriage assets, including the proposed family home, bearing in mind that the agreement would still share assisted increases in value and give credit for the sustenance of separate property,[50] or which preserved for each party their unequal ESA pre-relationship assets with ability to trace the equivalent ESA capital into replacement purchases and provision for compensation if intermingled with relationship property;[51] or which protected existing ESA while retaining the statutory regime for future acquired matrimonial property.[52] These were all cases in which, left to its own devices, the PRA would have converted all or part of the ESA into divisible relationship property.

Consciously or otherwise, these decisions illustrate a fundamental respect for the distinction between FOR and ESA. Judges rightly shrink from agreements which purport to deny one party, usually the wife, the right to share in wealth created by the activities of either or both during their relationship. But they have been entirely ready to uphold agreements which do no more than preserve the ownership of pre-relationship assets, third party gifts and inheritances, even though the PRA would have treated them as divisible relationship property.

What these decisions also show is the lack of any intuitive sympathy for the PRA's propensity for sharing ESA as if it were FOR. The parties should not have had to contract out in order to achieve something which should have been built into the statutory regime to begin with.

A suggested regime for NZ

All of this suggests that the PRA is failing to deliver what people want. Time and space do not permit a survey of its lesser anomalies. It is sufficient to focus on its propensity for converting ESA into divisible relationship property. That mischief was an inevitable

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[47] *Lowry v Lowry* [1994] NZFLR 529
[48] *Meng v Song* [2012] NZHC 3167.
[49] *DMF v GRH* [2008] NZFLR 425 (FC).
[50] *Wood v Wood* [1998] 3 NZLR 234, (1998) 17 FRNZ 1 (HC).
[51] *Harrison v Harrison* [2005] 2 NZLR 349 (CA).
[52] *Hartley v Hartley* [1986] 2 NZLR 64 (CA) at pp 69 line 37, 74 line 15 and 78 line 44.

consequence of the ill-advised attempt to divide property by reference to asset-type rather than concept.

Any reform now should start with an understanding of the FOR/ESA distinction and the rationale for sharing the former. The regime that would most closely reflect NZ norms and expectations is one which divided the fruits of the relationship in equal shares if and when a couple separates.

The finer details vary but there is ample precedent in community of surplus and community of acquest regimes overseas. Regimes of that kind reflect the concept that because contributions to wealth-creation by the breadwinner and the homemaker are inherently equal, the couple should share equally in the result of their joint and several efforts. Conversely, they should not share assets sourced from outside the operations of the partnership. Pre-relationship assets, inheritances, and third party gifts should remain with the original recipients.

If a community of surplus were adopted in principle, the answer to many secondary issues would follow. These include the way in which FOR and ESA capital would be traced or compensated for; the treatment of partnership efforts which enhance the value of ESA assets; the treatment of debts as between the two parties; sustenance of ESA; the relationship between the regime and family trusts; the deliberate destruction of property; the treatment of compensation for personal injury; and the apportionment of superannuation or pension rights.

Resolving details of that kind would be relatively easy if built on a clear and consistent rationale for the regime as a whole. The earlier discussion of intermingling illustrates the point. FOR and ESA are often intermingled due to purchases funded from both sources, their mixture in a common fund, or the injection of one into improvements to the other. Once the evidence established that both FOR and ESA had been channeled into the same asset, it is conceptually easy to estimate the extent to which each class of property contributed to its ultimate value. Broad estimates are more than sufficient for this purpose.

Jurisdictions founded upon distinct rationales need to be addressed in their own code or sub-code. One is compensation for relationship-caused disparities in earning capacity. A claim under this heading should be the subject of a distinct and additional award after the primary property regime had been applied. Whether this source of jurisdiction is dealt with in the relationship property legislation, or distinct legislation aimed at spousal support, is immaterial so long as it is not confused with the rationale for the primary property regime.

Consideration would also need to be given to the relationship between the primary property regime, on the one hand, and post-separation spousal and child support, on the other. The latter are currently catered for in existing legislation.[53] Whether there is any need for change in either of those areas is beyond the scope of this paper. What does seem worth noting is that the right to occupy the family home should be seen for what it is, an aspect of spousal or

[53] Family Proceedings Act 1980 and Child Support Act 1991.

child support, rather than an aspect of the primary property regime. Putting possession and occupation powers into the Family Proceedings Act, rather than the relationship property legislation, would bring together all matters relating to support and remove any room for confusion when applying the primary regime.

Would an enlightened statutory regime make contracting out redundant?

The right to contract out is presently necessary to counter anomalies in the PRA. The final question is whether there would remain any residual justification for contracting out if the anomalies were removed. Five aspects have a bearing on the answer:

- The false analogy of normal contracts
- Society's responsibility to protect the vulnerable
- Personal, family and social pressures
- Drafting challenges
- Could one size fit all?

The false analogy of ordinary contracts

In most spheres freedom of choice and freedom of contract are like motherhood and apple pie. They are rallying cries in areas as diverse as alternative dispute resolution and abortion. One can confidently predict that any attempt to whittle down the right to contract out from any new relationship property regime would be vigorously opposed in some quarters on philosophical grounds.

It will be pointed out that those who choose to enter into other relationships – partnerships, joint ventures, leases, franchise agreements and others – are free to choose the terms on which they will do so. The same unfettered approach will be sought for contracting out agreements, particularly by wealthy men.

In fact the analogy with other kinds of contract is inapt. A couple's marital relationship is more personal and emotional than commercial. It is likely to last for a very long time. During that time it will pass through many unforeseen changes of circumstance. Nor are a couple's property rights solely a matter for them. The outcome affects others such as the children of the relationship and the State. The State will need to step in with a welfare benefit if one party is left penniless. A closer analogy might be a residential tenancy, the terms of which are tightly controlled under the Residential Tenancies Act 1986. The case for freedom of contract on purely philosophical grounds is weak.

Society's responsibility to protect the vulnerable

Until the mid-twentieth century the Parliament was content to leave it to couples to determine for themselves how they would organise title to their property. The growing pressure for legislation such as the Joint Family Homes Act 1950, the Matrimonial Property Act 1963, Part VIII of the Matrimonial Proceedings Act 1963, the Matrimonial Property Act 1976, and

its extension to de facto relationships in 2001,[54] were all driven by developing social policy. The principal policy goal was to remove gender inequality in the disposition of property between husbands and wives. To a lesser extent it was also to protect children of the union. Leaving it to couples to make their own voluntary arrangements had not worked. Society as a whole had to step in and impose the solution which couples could have adopted voluntarily if they had been so minded.

To encourage contracting out now would be to return to laissez faire. It would leave it to individual couples to decide. But it is questionable whether they have the will, and the equality of bargaining power, to come up with a formula that would be fair to both. We do not permit couples to contract out of other laws created for the protection of the vulnerable – the Crimes Act, the Domestic Violence Act, the maintenance provisions of the Family Proceedings Act, the Care of Children Act, the Child Support Act, or the Family Protection Act. The values which those Acts support were considered to be too important to allow the parties to contract out.

This suggests that at the very least there should be no right to contract out from those aspects of property redistribution closely associated with a party's personal needs. The two aspects identified earlier were compensation for a relationship-caused disparity in earning capacity and the right to spousal support. They, at least, should be beyond the reach of contracting out.

As to the primary property regime itself, we should be slow to allow individuals to contract away spousal property rights that took over a hundred years of nurturing to develop.

Personal, family and social pressures

Contracting out agreements are not negotiated at arms-length, literal or metaphorical.

Modern marriages are normally the consequence of a period of such extreme affection that the couple commit to spending the rest of their lives together. There is a jarring incongruity between that happy state of affairs and the cold commercialism of a contracting out agreement. We should not be asking people to say "I will love you as no man has ever loved a woman before, greater than the mountains, deeper than the oceans, more enduring than the pyramids, and down through the aeons of time. And by the way would you sign this document that says if we break up you will have no claim on my pre-marriage assets." It is unrealistic to model the law on the assumption that if one party wishes to modify the default regime it is easy for him or her to ask the other to do so or, if such a request is made, that it is easy for the other to decline.[55]

In addition to that incongruity at a personal level, the potential for contracting out provides an opportunity for strong family and social pressures to be brought to bear on the parties. Parents sometimes let it be known that they want a contracting out agreement for their child to protect property that had emanated from, or is intended to emanate from, the family of origin. There

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[54] Property (Relationships) Amendment Act 2001, s 9.

[55] *MacLeod v MacLeod* [2008] UKPC 64, [36] and *Wood v Wood* [1998] 3 NZLR 234, (1998) 17 FRNZ 1 (HC) illustrate the problem.

can also be a strong public relations pressure where one party says "no contracting out agreement, no wedding" at a time when the invitations have already gone out, the dress has been bought, the photographer hired, the florist engaged and the marquee company booked.[56]

To a limited extent those pressures can be mitigated through legislation. An obvious step is to require independent advice and signing formalities before separate solicitors, as is presently the case.[57] Consideration might also be given to requiring execution of the agreement a minimum period before the marriage.[58] But as the Law Commission of England and Wales has recently pointed out, the time limit would need to be inordinately long if it is to precede the lead time required for modern weddings. The Commission also comments that such a time limit would simply divert the pressure from the eve of the wedding to an earlier date.[59] There is no ultimate antidote to the pressures placed on parties contemplating contracting out.

Drafting challenges

It is questionable whether many couples can access the expertise and farsightedness required to create a satisfactory alternative to a statutory regime.

A couple will obviously have the benefit of advice from their respective solicitors. But contracting out is not for the faint-hearted. In effect it calls for the creation of an ad hoc property regime tailored to the unforeseen future lives, as well as the present circumstances, of a particular couple.

Creating property regimes is challenging enough for experts and law reformers. Experience over many years suggests that the parties are expecting too much of their regular family solicitors when they ask them to come up with agreements that are tailored to the peculiar wishes of the clients yet are compatible with the rest of the PRA, unambiguous, workable, fair, and future-proof. The failure rate has been high. Litigation has frequently followed because the parties and their advisers cannot resort to existing authority to interpret their ad hoc creations.[60]

Drafting expertise may be greater in Europe. The execution of marriage contracts before Notaries has been a feature of Continental systems for several centuries. The acceptability of contracts there may have stemmed from the development of narrow conventions and standard forms over many years. Religious and social norms are also very different from those encountered in modern New Zealand.

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[56] As in *Wood v Wood*, above.

[57] PRA, s 21F.

[58] For example under Catalan law a pre-nuptial agreement must be concluded at least one month before the wedding – see further *Marital Agreements and Private Autonomy in Comparative Perspective* Jens M Scherpe ??? 498.

[59] Scherpe, above, 499.

[60] For two out of innumerable examples see *Harrison v Harrison* [1996] NZFLR 699 and *Moor v Marsten* 2015 NZCA 421.

The European experience might encourage Parliament to annex acceptable contracting out forms to the new statute. But what would be regarded as an acceptable alternative to the new regime? Obvious candidates at the moment are agreements to prevent the unwarranted conversion of ESA to divisible relationship property.[61] But the place to put terms which couples routinely want is in the statutory regime itself. Once that is done, it is difficult to see what role would remain for sanctioned alternatives.

Could one size fit all?

It will undoubtedly be argued that no single relationship property regime could be expected to cater for all couples and all situations. Every couple, and every relationship, is unquestionably different.

The infinite differences between individuals has never deterred Parliament from enacting laws of general application. As noted earlier, there is little or no opportunity to contract out of other family law legislation, no matter how idiosyncratic the family or its circumstances.

The courageous course would be to abolish contracting out altogether. But it is difficult for reformers to foresee every eventuality. The more craven, but probably more realistic, course would be to retain the right but couple it with an onus on the party seeking to uphold the agreement.

On that approach the onus on the proponent of a contracting out agreement could be the deliberately high one of persuading the Court that (i) application of the statutory regime would not have achieved the fundamental objects of the regime, or for some other reason would have been unjust, and (ii) the application of the agreement would be just in all the circumstances. If the proponent failed to discharge the onus the agreement would be void.

Summary

My views can be summarised as follows:

(a) The PRA was an inspired social ideal compromised by its inept execution. The greatest anomalies have resulted from its confusion between (i) capital created by a couple's joint and several efforts during the relationship (FOR) and (ii) externally sourced assets such as those owned before the relationship began and those subsequently acquired by third party gift or inheritance (ESA).

(b) Contracting out is presently the only way in which couples can preserve their own ESA. The Courts will normally uphold agreements entered into for that purpose while setting aside agreements calculated to prevent equal division of FOR. In doing so the Courts are instinctively endorsing the fundamental distinction between FOR and ESA.

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[61] For possible precedents see *Fisher on Matrimonial and Relationship Property* (LexisNexis) 40,101 to 40,206.

(c) Whether and to what extent we should permit contracting out depends on the statutory regime we adopt to replace the PRA.

(d) The new regime should be founded upon equal sharing of FOR and non-sharing of ESA.

(e) Once that foundation were adopted, the concept on which it rested could be carried through into many secondary topics, such as tracing, intermingling and increases in value. It would be a mistake to descend into detailed rules based on asset-type, common use, common benefit, and matters better left to valuers.

(f) For clarity of reasoning, it should be recognised that compensation for earning disparity, and spousal support, have distinct rationales and require distinct assessments. Those jurisdictions should be exercised after application of the primary statutory regime.

(g) One party should be entitled to earnings disparity compensation from the other amounting to half the present value of any relationship-caused disparity in earning capacity. The compensation should be a matter of entitlement rather than the exercise of a judicial discretion.

(h) As is presently the law, one party should also be entitled to post-separation spousal support in limited circumstances. Possession and occupation of relationship property should be seen as an aspect of support for spouses and children. There should also be a power to discharge support obligations by the transfer of property as an alternative to payment in the form of a lump sum or periodical payments.

(i) It should not be possible to contract out from earnings disparity compensation or the right to spousal support.

(j) If the primary statutory regime is carefully drafted there should be little or no need for contracting out.

(k) Even with an enlightened statutory regime, the safer course is probably to retain a power to contract out but with a heavy onus on the party seeking to uphold the agreement.

(l) The onus on the proponent of an agreement should be the high one of showing that (i) application of the statutory regime would not have achieved the fundamental objects of the regime, or for some other reason would have been unjust, and (ii) application of the agreement would be just in all the circumstances.