IN THE SUPREME COURT OF NEW ZEALAND

SC 62/2005
[2006] NZSC 31

BETWEEN	ROBERT ARTHUR FELTON AND NORAH ISABEL FELTON First Appellants
AND	JAMES GERRARD FLYNN AND MARION EDITH MAE FLYNN Second Appellants
AND	DAVID RONALD LEESE Third Appellant
AND	COLIN GRAEME SMITH AND CHRISTINA DOROTHY SMITH Fourth Appellants
AND	ALAN RAYMOND TUCKER AND MARION JUNE TUCKER Fifth Appellants
AND	CLEAR-SHIELD CHRISTCHURCH LTD Sixth Appellant
AND	ANNETTE FRANCES JOHNSON Respondent

Hearing: 24 February 2006

Court: Elias CJ, Blanchard, Tipping, Anderson and Henry JJ

Counsel: D G Smith and J C Bassett for Appellants
D G Hurd and M J Allan for Respondent

Judgment: 27 April 2006

JUDGMENT OF THE COURT

A. The appeal is dismissed.

B. The appellants are to pay the respondent costs of $15,000 together with reasonable disbursements to be fixed if necessary by the Registrar.

REASONS

(Given by Blanchard J)

Background

[1] Mr and Mrs Johnson entered into a matrimonial property agreement on 11 October 1993. At the time, Mr Johnson, through a limited liability company, had entered into contracts with a number of franchisees for the distribution of a product called "Clear-Shield". By 1993 the franchisees were expressing dissatisfaction with the product, although there was no suggestion at the time of litigation against Mr Johnson personally. The matrimonial property agreement created an imbalance, on its face, in Mrs Johnson's favour of $45,000. The major portion of the share of the property allocated to the husband was however in the form of shares in his companies. If, as later proved to be the case, the shares were worthless, the imbalance was very much greater.

[2] The franchisees did not start proceedings until 1997 – more than two years after the matrimonial property agreement. They sought damages against Mr Johnson and as against both Mr and Mrs Johnson to have the matrimonial property agreement set aside under s 47 of the Property (Relationships) Act 1976 which in relevant part reads:[1]

> **47 Agreements to defeat creditors void**
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> (1) Any agreement, disposition, or other transaction between spouses or de facto partners with respect to their relationship property and intended to defeat creditors of either spouse or de facto partner is void against those creditors and the Official Assignee.

[1] Before amendment in 2001 the elements of the two subsections were combined in one subsection which did not extend to de facto partners. Nothing appears to turn upon this amendment.

> (2) Any such agreement, disposition, or other transaction that was not so intended but that has the effect of defeating such creditors is void against such creditors and the Official Assignee during the period of 2 years after it is made, but only to the extent that it has that effect.

[3] Damages in excess of $800,000 for deceit were eventually awarded against Mr Johnson,[2] who was adjudicated a bankrupt on 31 October 2001. The Official Assignee was joined later as a co-plaintiff to the proceedings in respect of the property agreement claim.

[4] The claim of the Official Assignee was dealt with first. In a judgment in October 2003 Venning J held that the franchisees were creditors of Mr Johnson as at October 1993 for the purposes of s 47.[3] The Judge ascribed no value to Mr Johnson's shares and found that there was an imbalance of $552,250 between what was received by Mrs Johnson and her actual entitlement under the Act and that the agreement therefore had the effect of defeating creditors. Significantly, however, he rejected a claim under s 47(1) that the agreement had been entered into with the intention of defeating the husband's creditors and there has been no appeal against this determination. Venning J also held that s 47(2) did not apply because the Official Assignee had not been appointed within two years of the matrimonial property agreement.

[5] In a second judgment in February 2004[4] dealing with the claim by the franchisee creditors under s 47(2), Venning J proceeded on the basis of the conclusions he had reached in his earlier judgment that the franchisees were creditors at the time of the matrimonial property agreement and that the agreement had the effect of defeating creditors. Venning J then had to consider the question which arises on the present appeal, namely whether the franchisees were prevented from bringing their claim under s 47(2) because it was not commenced within two years of the date of the agreement. This question was before him for determination by summary judgment under the r 418 procedure in the High Court Rules. He held that s 47(2) did not fix the time within which creditors or the Official Assignee must take

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2 HC AK CP 6/97 21 December 1999 Goddard J.
3 HC AK CIV-1997-404-000182 8 October 2003.
4 (2004) 24 FRNZ 83.

proceedings. Rather "it defines the parties who may challenge the agreement".[5] The Judge said that such parties must qualify within two years of the agreement:[6]

> In the case of the Official Assignee, he must have been appointed within that time. In the case of creditors, they must satisfy the Court they were creditors of one of the spouses … during the two years immediately following the agreement.

As the franchisees were creditors at the time of the agreement judgment was accordingly entered for them against Mrs Johnson in the sum of $552,250 together with interest and costs.

[6] Venning J's judgment of 12 February 2004 was set aside by majority decision of the Court of Appeal.[7]

[7] McGrath J and Glazebrook J, the majority Judges, took the view that the relevant time for consideration of both limbs of s 47 is the date of the agreement, disposition, or other transaction in question. They considered that the phrase "during the period of 2 years after it is made" makes it clear that the agreement is void against creditors only during the period specified. The phrase therefore describes a limitation period, not a period within which anyone who is or becomes a creditor of either spouse must be identified. This interpretation was thought to fit more easily into the scheme of the Act and the general insolvency regime, including s 60 of the Property Law Act 1952 which provides:

> **60 Alienation with intent to defraud creditors**
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> (1) Save as provided by this section, every alienation of property with intent to defraud creditors shall be voidable at the instance of the person thereby prejudiced.
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> (2) This section does not affect the law of bankruptcy for the time being in force.
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> (3) This section does not extend to any estate or interest in property alienated to a purchaser in good faith not having, at the time of the alienation, notice of the intention to defraud creditors.

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5 At [53].

6 At [53].

7 [2006] NZFLR 49 (McGrath J and Glazebrook J; William Young J dissenting in part).

[8] The majority Judges pointed to the inconvenience of an interpretation which permits new creditors of either spouse or de facto partner to treat a relationship property agreement as void when in many cases the spouses or partners will have separated and set up new lives. They considered there was no obvious policy reason "why the interests of creditors should, after a reasonable period has elapsed, be favoured over a spouse or partner who received no more than his or her entitlement" under the Act.[8] Two years was considered a "reasonable period" in the context of the Insolvency Act 1967 and there was no reason to require a longer period when relationship property was involved. Although the franchisees were creditors at the time of the agreement, no steps were taken by them during the next two years. After those two years had lapsed it became too late for the franchisees to impugn the agreement under s 47(2).

[9] William Young J, dissenting, considered that what he perceived as an "unfair" result for the franchisees was a direct consequence of the majority's interpretation of s 47(2).[9] He took the view, in agreement with Venning J, that the use of the word "void" in s 47 was important, particularly given the partial derivation of the section from s 60 of the Property Law Act where "voidable" rather than "void" was used. By analogy with cases decided under s 60, William Young J reasoned that "creditors" in s 47 was not limited to creditors in existence at the time of the agreement, but included creditors whose claims arose after the making of the agreement (future or subsequent creditors). The consequence of the reasoning of the Court of Appeal in *Neill v Official Assignee*[10] was that the agreement could only be impugned as detrimental to such creditors if its making exacerbated an existing state of insolvency or caused the transferor spouse to become insolvent. The present case fell into the former category if, as Venning J found, the claims by the franchisees were treated as debts. William Young J considered it clear that an agreement that is to the detriment of creditors *defeats* those creditors to the extent that it gives a spouse more than his or her "entitlement" under s 20 of the Act. In this case, the protected interest of the wife in the relationship property was only $61,000 and the defeating effect was therefore significant. The function of s 47(2), which unlike s 47(1) does

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8 At [140].
9 At [67].
10 [1995] 2 NZLR 318.

not address situations where an agreement was intended to defeat creditors, was in William Young J's view to divide subsequent creditors into two classes, namely those whose debts arose within two years of the impugned agreement and those whose debts arose more than two years after the agreement. Creditors in the first class, together with existing creditors like the franchisees in the present case, could invoke s 47(2) and treat the agreement as void, but those in the second class could not. The Judge considered this to be a "perfectly sensible (if perhaps rough and ready) distinction" that produced a practical result and was not inconsistent with the insolvency regime.[11] He accordingly agreed with the approach taken by Venning J.

Discussion

[10] Subsection (1) of s 47 is concerned with an agreement, disposition, or other transaction between spouses or de facto partners with respect to their relationship property that is intended to defeat creditors of either spouse or partner. Such a transaction is made "void" against those creditors and the Official Assignee. Subsection (2) is directed to a transaction which, without having that malign intention, does have the effect of defeating creditors. Such a transaction is declared to be void against the same persons "during the period of 2 years" after the transaction, but only to the extent that it has the effect of defeating them.

[11] This appeal requires the Court to elucidate subs (2) but it is helpful, in our view, to concentrate first on subs (1) because much of its language is carried over into subs (2) with the variations which have been mentioned. An expression appearing in both subsections, like "void", must bear the same meaning in both. Indeed, in the case of "creditors" it is plain that both subsections are speaking of the same persons for subs (2) twice refers to "such creditors", namely those mentioned in subs (1).

[12] The statutory antecedents of s 47(1) can readily be seen. It is obviously intended in the field of domestic relationships to fulfil the same role as the more generally applicable s 60(1) of the Property Law Act 1952 which provides that

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[11] At [92].

"every alienation of property with intent to defraud creditors shall be voidable at the instance of the person thereby prejudiced". But in accordance with subs (3), the application of s 60(1) "does not extend to any estate or interest in property alienated to a purchaser in good faith not having, at the time of the alienation, notice of the intention to defraud creditors". As will be seen, the qualification found in subs (3) does not mean that s 60 actually operates any differently from s 47(1) in relation to third parties.

[13] Section 47(1) appears to have an even earlier derivation than s 60 for, in apparent contrast to s 60(1), it uses the word "void" rather than "voidable". That suggests that the drafter had in mind the ancestor of s 60, namely the Statute of Elizabeth 1571,[12] which in the florid language of its time declared alienations and other dealings "to the end, purpose and intent, to delay, hinder or defraud creditors" to be "clearly and utterly void, frustrate, and of none effect". Hardie Boys J recognised this in *Walsh v Powell*:[13]

> …I respectfully adopt the conclusion of Hutchison J in *In Re Proudfoot (a bankrupt)* [1960] NZLR 577, 581 that the authorities on the Elizabethan statute should be applied to s. 60 of our Act of 1952. Furthermore, in my opinion the essential wording, and the intent, of s. 47 of the Matrimonial Property Act is such that the same principles are appropriate to it also.

[14] Three matters are of present interest in relation to the Statute of Elizabeth:

(a) who could invoke it;

(b) how it could be invoked; and,

(c) its effect when invoked, particularly on third parties who had since the alienation innocently and for value acquired an interest in the alienated property.

[15] The Statute could be invoked by anyone who was a creditor at the time of the alienation of the debtor's property and was prejudiced by that alienation. It could also be invoked by someone who subsequently became a creditor and was thereby prejudiced.[14] An instructive instance of the scope of the Statute is found in the decision of Malins V-C in *Mackay v Douglas*[15] where a bankrupt had entered into a

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12 13 Eliz 1 c 5.

13 (1982) 5 MPC 180, 182 (HC); also reported as *W v P* (1982) 1 NZFLR 103.

14 *Cadogan v Cadogan* [1977] 1 WLR 1041, 1059 (CA).

15 (1872) LR 14 Eq 106. To similar effect see *Richardson v Smallwood* (1822) Jac 552; 37 ER 958.

voluntary settlement of his real estate in favour of his family just before joining a partnership which he knew to be engaged in hazardous business ventures. The settlement was held to be void against persons who became creditors of the new firm. Malins V-C remarked that "a man who contemplates going into trade cannot on the eve of doing so take the bulk of his property out of the reach of those who may become his creditors in his trading operations".[16] On the other hand, Malins V-C made the important distinction that "if a man is solvent at the time and after the time of taking away the property which is put into the settlement he remains solvent, and does not at the time contemplate doing anything which could lead to insolvency, the settlement will be good".[17]

[16] The position seems in that respect to be the same under s 60 and, we think, also under s 47(1): that future creditors who have been prejudiced by a transaction between spouses or de facto partners intended to defeat creditors can resort to s 47(1). So, accordingly, can such creditors, along with existing creditors, take advantage of subs (2) when the transaction unintentionally defeats them. It is for present purposes unnecessary to decide whether they can do so only if there were existing creditors at the time of the transaction who remain unpaid.[18] Whether a present or future creditor is in fact prejudiced by a transaction is a matter which has to be addressed at the time it occurs. As Richardson J said in *Neill v Official Assignee*, it is necessary to make "an overall assessment of the agreement at the time it is entered into in order to determine whether or not it then has the effect of defeating any present or future creditors".[19]

[17] The next question is how the Statute of Elizabeth could have been invoked. A creditor entitled to invoke it (or, now, s 60 of the Property Law Act) could do so either in a proceeding relying upon the Statute or, if the creditor already had a judgment against the debtor, by electing to treat the alienated property as if it still belonged to the debtor and levying execution on it. In the latter case there was no need for further resort to the Court.[20] What was necessary in all cases, however, was

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16 At 122.
17 At 121.
18 *Crossley v Elworthy* (1871) LR 12 Eq 158, 168.
19 At 322.
20 *Shears v Rogers* (1832) 3 B & Ad 363; 110 ER 137.

some active election or step by creditors. In a case concerned with s 60, *Kareltrust v Wallace and Cooper Engineering (Lyttelton) Ltd*,[21] the Court of Appeal, drawing upon the decision of the High Court of Australia in *Brady v Stapleton*,[22] said that the creditor must "manifest an election" against the transaction.

[18] The final question on the Statute of Elizabeth concerns the effect of such an election. Notwithstanding the vehemence of the words "clearly and utterly void, frustrate, and of none effect", the Courts long ago protected the position of innocent purchasers for value of the debtor's property by deciding that, as it was put by Dixon CJ and Fullagar J in *Brady*,[23] "a fraudulent assignment [is] effective unless and until a creditor or creditors intervene by levying execution or taking legal proceedings". In the same judgment it was said that:[24]

> …a fraudulent assignment by a debtor is not held void where the effect of so holding would be to defeat *either* a purchaser for value without notice from the fraudulent debtor *or* a purchaser for value without notice from an assignee of the debtor, whether that assignee were himself a purchaser for value without notice or not.

This is made explicit in s 60 by the use of "voidable" rather than "void" and by subs (3) which prevents the use of the section against a purchaser in good faith without notice of the fraudulent intention of the alienation.

[19] Under the Statute of Elizabeth, accordingly, the alienee was treated as having a defeasible title unless and until the transaction was set aside. Interestingly, *Halsbury's Laws of England*[25] states that where a conveyance is set aside, then unless the Court is satisfied that nothing can in any possible event come to the transferee after the creditors have been paid, the proper form of order is not that the conveyance be delivered up to be cancelled, but that the transferee do all things necessary to make the property comprised in the conveyance available for the claims of the creditors.[26]

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21 [2000] 1 NZLR 401 at [74].
22 (1952) 88 CLR 322.
23 At 333.
24 At 333 (emphasis in original).
25 (4ed, Reissue, 1976) vol 18, para 386.
26 See *Ideal Bedding Co Ltd v Holland* [1907] 2 Ch 157, 173-174.

[20] In our view, s 47(1) is properly to be understood as an adaptation of the concepts underlying the Statute of Elizabeth and s 60, as interpreted by the Courts, to the situation of transactions between spouses and de facto partners. A transaction which is intended to defeat creditors of either of them is liable to be set aside by any creditor who can be seen to have been prejudiced by the making of the transaction. In the event of a challenge by such a creditor the transaction is regarded as having been set aside to the extent necessary to satisfy the claim of the creditor but, as was the case with the Statute of Elizabeth, it is not to be treated as having been void *ab initio*. Only after electing to invoke s 47(1), and subject to the rights of innocent purchasers for value, can the creditor have recourse to the property in question.

[21] Subsection (2) is a modification of subs (1) but the underlying concepts are the same. The creditors of which it speaks are the same persons ("such creditors"). It deals with transactions which have unintentionally prejudiced them. Such transactions are "void" against creditors only "during the period of 2 years after the [transaction] is made". Read against the historical background which we have outlined, where "void" has been understood to mean void if a creditor elects to treat it as such, the natural meaning of subs (2) is that the transaction must be challenged by a creditor "within" the two years. It is "void" only "during" that time. Afterwards, it is not void. If, within two years of the transaction, a creditor brings a proceeding under s 47(2) or levies execution of a judgment against the debtor spouse or partner on the property in question the transaction is avoided, and to the extent necessary to meet the claim the property re-vests in the person who disposed of it.[27] But since s 47 makes the impugned transaction void only against creditors and the Official Assignee, any such re-vesting is subject to the rights of purchasers for value without notice that the transaction had the effect of defeating any creditor.

[22] Read in this way, the sub-section is given a meaning which sensibly distinguishes it from subs (1). To read the reference to a two year period, as the High Court Judge and the dissenting Judge in the Court of Appeal did, as merely defining the future creditors who can invoke s 47(2) would be to create a situation where there was really no practical difference between the two subsections. It is

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[27] The express limitation in subs (2) ("but only to the extent that it has that effect") is seemingly implicit in subs (1), as it is in the Statute of Elizabeth and s 60.

most unlikely that, even in a situation akin to that in *Mackay v Douglas*, future creditors will not only appear more than two years after a transaction but will also be able to show the requisite prejudice from the time of the transaction. There is no attraction in the suggestion, made by Mr Smith for the first time in oral argument in this Court, that the two year period could be read as referring to the time within which an existing or future creditor must actually be defeated by the disposition, for the prejudice must, as the Court of Appeal indicated in *Neill v Official Assignee*, be such as to have existed from the time of the transaction, as it did for the creditors of the new partnership in *Mackay v Douglas*.

[23] It follows that, as none of Mr Johnson's creditors did anything during the two year period which could possibly amount to an election to rely on s 47(2), the appeal must fail.

[24] The position of the Official Assignee under the section does not arise on this appeal. It does seem to us to be a matter of considerable difficulty. It is uncertain whether it is sufficient for the purposes of s 47(2) that there has been an adjudication during the two year period or whether the Official Assignee must also during that time take some step which invokes the section. It is uncertain also whether and to what extent a claim by the Official Assignee would displace the claims of individual creditors. We recommend legislative attention to s 47.

Result

[25] The appeal is dismissed with costs of $15,000 to the respondent together with her reasonable disbursements to be fixed if necessary by the Registrar.

Solicitors:
R P Benton, Auckland for Appellants
Patterson Hopkins, Auckland for Respondent