

## EQUITABLE ACCOUNTING AFTER *STACK v DOWDEN*

### The typical situation:

1. Mr & Mrs Smith married in 1985 and purchased their home in 1988 with the assistance of a sizeable mortgage from a high street bank. They are the joint registered proprietors of the property. In 1992 Mr Smith was made bankrupt upon his own petition. At that time the Official Receiver took no steps to realise Mr Smith's interest in the property (there was no, or very little, equity in the property at that time, the value of the property being about £80,000, and the mortgage debt about £78,000). In 2004 the Protracted Realisations Unit reviewed the case and appointed a trustee in bankruptcy. Mr & Mrs Smith made no sensible proposals for the purchase of the trustee's interest in the property and the trustee commenced proceedings for an order for sale & possession. At the time of the hearing of the application the property is valued at £360,000 and the outstanding mortgage debt is £70,000.
2. In the 13 years since the bankruptcy order Mrs Smith has paid about £100,000 to the bank under the mortgage, the vast majority of which (about £92,000) comprises interest only. In addition she has paid for maintenance & improvement of the property.

### Equitable accounting before *Stack v Dowden*

3. The principles are well known and well worn. Equitable accounting does not affect the beneficial ownership of the property, but it will affect the way in which the proceeds of sale are distributed.
4. Typically where one joint owner leaves the property and is not welcome back, that joint owner will be entitled to the payment of a notional market rent from the remaining joint owner who continues to occupy and enjoy the property. So, for instance, in the case of joint owners in equal shares, the occupying owner would account to the ousted owner for 50% of a notional market rent.
5. On the other hand, typically the occupying owner pays the mortgage (interest and capital), maintains the property, meets local taxes on the property, and perhaps even expends money improving the property. In that situation the occupying owner is likely to be entitled to:
  - (1) one half (or the applicable proportion) of the capital elements of the mortgage repayments;
  - (2) one half (or the applicable proportion) of the interest elements of the mortgage repayments;
  - (3) one half (or the applicable proportion) of the increase in value of the property resulting from expenditure on repairs and improvements, or one half (or the applicable proportion) of the expenditure if less
6. Where the property is owned in unequal shares the accounting is varied proportionately, so, for instance, in a case where the ousted owner was entitled to a 75% beneficial interest, and the occupying owner a 25% interest, the ousted owner would be entitled to 75% of the occupation rent, and the occupying owner would be entitled to 75% of the increase in value/cost of any improvements.
7. It is often suggested that there is a rule of thumb or convenience that the quantum of the occupying owner's claim in respect of mortgage repayments is deemed to be the same as the claim of the ousted owner's claim for an occupation rent (see for instance the suggestion of Vinelott J in *re Gorman (a bankrupt)* [1990] 1 WLR 616). However such a rule is hardly likely to be appropriate where there are unequal beneficial shares in the property, or where the value of the property is high in comparison to the mortgage debt.

8. The fact that the trustee in bankruptcy has not been ousted or excluded from the property has not unduly troubled the Courts in assessing the broad equities of the typical bankruptcy situation. The following extracts from leading cases demonstrate how a trustee in bankruptcy in the typical situation is treated in a similar manner to the ousted owner:

**re Gorman (a bankrupt)** [1990] 1 WLR 616 Vinelott J

“The more difficult question is whether Mrs Gorman is entitled to be credited with one half the mortgage instalments she has paid, and whether she is liable to be debited with one half of an occupation rent” [625B]

“After ascertaining the shares, the next problem arises when it is to be turned into money. Usually one of the parties stays in the house, paying the mortgage instalments and the rate and other outgoings. The house also increases in value greatly owing to inflation. None of that alters the shares of the parties in the house itself. But it does mean that when the house is sold – or the one buys the other out – there have to be many adjustments made. The value of the house itself is taken at the value at the time of the sale or buying out. There must be deducted from it all the money needed to redeem the mortgage. Then the one in possession must be given credit for paying the other’s share of the mortgage instalments and be debited with an occupation rent for using the other’s share of the house. Other adjustments may be needed for other outgoings. Then the net must be divided according to the shares” [at 625D citing Lord Denning in *Bernard v Josephs*]

“So far as my recollection goes, it has been the normal practice in this class of case to allow the occupying spouse to take credit for repayments of capital but not of interest, because he or she has had the benefit of the use of the house. It was certainly so where the husband was in occupation, although it may not always have been the case where the wife, and particularly the children, were in occupation” [at 626E citing Ormrod LJ in *Suttill v Graham*]

“The payment of instalments due under the mortgage operates to relieve the property from the charge and gives rise to an equitable right of contribution by the co-owner who has not paid his due proportion of the instalments” [626H]

“On the other hand, it seems to me that, as in the case of instalments paid since the receiving order was made, she is entitled to require that a half share of the instalments, which as between co-owners ought to have been contributed equally, should be brought into account against his share of the proceeds of sale... It follows in my judgement that in default of agreement between the parties, there will have to be an inquiry into the amount of the proper occupation rent, between the making of the receiving order and the sale of the property, and an account of all the mortgage instalments paid by Mrs Gorman before and after the receiving order was made. One half of the occupation rent will have to be debited and one half of the mortgage instalments credited to Mrs Gorman’s share” [627H]

**Re Pavlou** [1993] 1 WLR 1046 per Millett J

“On a partition suit or an order for sale adjustments could be made between the co-owners, the guiding principle being that neither party could take the benefit of an increase in the value of the property without making an allowance for what had been expended by the other in order to obtain it: see *Leigh v Dickeson* (1884) 15 QBD 60” [page 1048G]

“The guiding principle of the Court of Equity is that the proportions in which the entirety should be divided between former co-owners must have regard to any increase in its value which has been brought about by means of expenditure by one of them” [page 1048H]

“The same applies in my judgement to any capital element in the repayment of mortgage instalments. The repayment of the capital element in each instalment increases the value of the equity of redemption which inures to the benefit of both joint tenants” [page 1049C]

"I take the law to be to the following effect. First, a Court of Equity will order an inquiry and payment of occupation rent, not only in the case where the co-owner in occupation has ousted the other, but in any other case in which it is necessary in order to do equity between the parties that an occupation rent should be paid. The fact that there has not been an ouster or forceful exclusion therefore is far from conclusive. Secondly, where it is a matrimonial home and the marriage has broken down, the party who leaves the property will, in most cases, be regarded as excluded from the family home, so that an occupation rent should be paid by the co-owner who remains. But that is not a rule of law; that is merely a statement of the prima facie conclusion to be drawn from the facts. The true position is that if a tenant in common leaves the property voluntarily, but would be welcome back and would be in a position to enjoy his or her right to occupy, it would normally not be fair or equitable to the remaining tenant in common to charge him or her with an occupation rent which he or she never expected to pay." [page 1050D-E]

**Re Byford (deceased)** [2003] EWHC 1267 Ch, [2003] BPIR 1089 per Lawrence Collins J

"[40] What the Court is endeavouring to do is broad justice or equity as between co-owners. As Millet J said in *Re Pavlou* (a bankrupt) [1993] 1 WLR 1046, the fact there has not been an ouster or forcible exclusion is not conclusive. The trustee cannot reside in the property nor can he derive any financial enjoyment from the property while the bankrupt's spouse resides in it, and the bankrupt spouse's creditors can derive no benefit from it until he exercises his remedies. I do not consider that the policy expressed in the new s283A of the Insolvency Act 1986 is of any assistance (even if it had been in force). It is true that the trustee could have realised his remedies earlier, but Mrs Byford benefited to a considerable degree by his inaction, while Mr Byford enjoyed the use of the property with Mrs Byford, without any benefit to his creditors.

[41] In those circumstances, where Mrs Byford seeks and obtain an account of interest payments, the trustee is entitled to a set-off for occupation rent, and I therefore dismiss the appeal. I would have preferred the trustee's submissions on interest on the interest payments, if that issue had arisen for decision."

### ***Stack v Dowden* [2007] UKHL 17, [2007] 2 WLR 831**

9. *Stack v Dowden* is widely reported as a seminal authority in ascertaining the beneficial interests of co-owners in domestic circumstances. However the House of Lords dealt briefly with the equitable accounting element of the case, and appeared to point out that the legal profession had missed a trick; that ever since the commencement of the Trust of Land and Appointment of Trustees Act 1996 ("TLTA") any equitable accounting was to be conducted under the statutory framework of sections 12 to 15 of TLTA.

10. Per Baroness Hale:

"93. There remains the question of the payment for Mr Stack's alternative accommodation. This matter is governed by the Trusts of Land and Appointment of Trustees Act 1996. Section 12(1) gives a beneficiary who is beneficially entitled to an interest in land the right to occupy the land if the purpose of the trust is to make the land available for his occupation. Thus both these parties have a right of occupation. Section 13(1) gives the trustee the power to exclude or restrict that entitlement, but under section 13(2) this power must be exercised reasonably. The trustees also have power under section 13(3) to impose conditions upon the occupier. These include, under section 13(5), paying any outgoings or expenses in respect of the land and under section 13(6) paying compensation to a person whose right to occupy had been excluded or restricted..."

**94. These statutory powers replaced the old doctrine of equitable accounting under which a beneficiary who remained in occupation might be required to pay an occupation rent to a beneficiary who was excluded from the property. The criteria laid down in the statute should be applied, rather than in the cases decided under the old law, although the results may often be the same ..."**

11. Per Lord Neuberger:

“150. The Court’s power to order payment to a beneficiary, excluded from property he would otherwise be entitled to occupy, by the beneficiary who retains occupation, **is now governed by sections 12 to 15 of the Trusts of Land and Appointment of Trustees Act 1996, having been formerly equitable in origin.** However, I think that it would be a rare case where the statutory principles would produce a different result from that which would have resulted from the equitable principles.”

## The Trusts of Land and Appointment of Trustees Act 1996

12. The broad outline of sections 12 to 15 of TLTA is as follows:

- (1) section 12 gives a beneficiary the right to occupy the property if, amongst other things, the purposes of the trust include making the land available for his occupation;
- (2) where 2 or more beneficiaries are entitled to occupy the property under section 12, sections 13 provides a scheme whereby the trustees of the property regulate occupation of the property by one or more of the beneficiaries, imposing terms, including the payment of compensation;
- (3) section 14 provides that anyone with an interest in the property can apply to the Court for an order in respect of the trustees’ functions, which includes the imposition of conditions and payments under section 13;
- (4) section 15 sets out the matters to which the Court is to have regard in determining an application under section 14.

13. It is necessary for reference purposes to set out the full statutory scheme of TLTA. The more relevant paragraphs are highlighted in bold.

### “12 The right to occupy

- (1) A beneficiary who is beneficially entitled to an interest in possession in land subject to a trust of land is entitled by reason of his interest to occupy the land at any time if at that time
  - (a) the **purposes of the trust include making the land available for his occupation** (or for the occupation of beneficiaries of a class of which he is a member or of beneficiaries in general), or
  - (b) the **land is held by the trustees so as to be so available.**
- (2) subsection (1) **does not confer on a beneficiary a right to occupy land if it is either unavailable or unsuitable for occupation by him.**
- (3) This section is subject to section 13.

### 13 Exclusion and restriction of right to occupy

- (1) Where two or more beneficiaries are (or apart from this subsection would be) **entitled under section 12 to occupy land**, the trustees of land **may exclude or restrict the entitlement of any one or more (but not all) of them.**
- (2) Trustees may not under subsection (1) –
  - (a) unreasonably exclude any beneficiary’s entitlement to occupy land, or
  - (b) restrict any such entitlement to an unreasonable extent.

- (3) The trustees of land may from time to time impose reasonable conditions on any beneficiary in relation to his occupation of land by reason of his entitlement under section 12.
- (4) The matters to which trustees are to have regard in exercising the powers conferred by this section include –
  - (a) the intentions of the person or persons (if any) who created the trust,
  - (b) the purposes for which the land is held, and
  - (c) the circumstances and wishes of each of the beneficiaries who is (or apart from any previous exercise by the trustees of those powers would be) entitled to occupy the land under section 12.
- (5) The conditions which may be imposed on a beneficiary under subsection (3) include, in particular, conditions requiring him –
  - (a) to pay any outgoings or expenses in respect of the land, or
  - (b) to assume any other obligation in relation to the land or to any activity which is or is proposed to be conducted there.
- (6) **Where the entitlement of any beneficiary to occupy land under section 12 has been excluded or restricted, the conditions which may be imposed on any other beneficiary under subsection (3) include, in particular, conditions requiring him to –**
  - (a) make payments by way of compensation to the beneficiary whose entitlement has been excluded or restricted, or**
  - (b) forgo any payment or other benefit to which he would otherwise be entitled under the trust so as to benefit that beneficiary.**
- (7) The powers conferred on such trustees by this section may not be exercised –
  - (a) so as to prevent any person who is in occupation of land (whether or not by reason of an entitlement under section 12) from continuing to occupy the land, or
  - (b) in a manner likely to result in any such person ceasing to occupy the land,unless he consents or the court has given approval.
- (8) The matters to which the Court is to have regard in determining whether to give approval under subsection (7) include the matters mention in subsection (4)(a) to (c)

#### 14 Applications for order

- (1) Any person who is a trustee of land or has an interest in property subject to a trust of land may make an application to the Court for an order under this section.
- (2) On an application for an order under this section the Court may make any such order –
  - (a) relating to the exercise by the trustees of any of their functions (including an order relieving them of any obligation to obtain the consent of, or to consult, any person in connection with the exercise of any of their functions), or
  - (b) declaring the nature or extent of a person's interest in property subject to the trust, as the Court thinks fit
- (3) The Court may not under this section make any order as to the appointment or removal of trustees

- (4) The powers conferred on the Court by this section are exercisable on an application whether it is made before or after the commencement of this Act.

#### 15 Matters relevant in determining applications

- (1) The matters to which the Court is to have regard in determining an application for an order under section 14 include –
- (a) the intentions of the person or persons (if any) who created the trust,
  - (b) the purposes for which the property subject to the trust is held,
  - (c) the welfare of any minor who occupies or might reasonably be expected to occupy any land subject to the trust as his home, and
  - (d) the interests of any secured creditor of any beneficiary.
- (2) **In the case of an application relating to the exercise in relation to any land of the powers conferred on the trustees by section 13, the matters to which the Court is to have regard also include the circumstances and wishes of each of the beneficiaries who is (or apart from any previous exercise by the trustees of those powers would be) entitled to occupy the land under section 12**
- (3) In the case of any other application, other than one relating to the exercise of the power mentioned in section 6(2), the matters to which the Court is to have regard also include the circumstances and wishes of any beneficiaries of full age and entitled to an interest in possession in property subject to the trust or (in the case of dispute) of the majority (according to the value of their combined interests).
- (4) **This section does not apply to an application if section 335A of the Insolvency Act 1986 (which is inserted by Schedule 3 and relates to applications by a trustee of a bankrupt) applies to it.**

#### **MURPHY v GOOCH [2007] EWCA Civ 603**

14. In the subsequent case of *Murphy v Gooch* (a non-bankruptcy co-ownership dispute), the Court of Appeal confirmed the approach of the House of Lords in *Stack v Dowden*, Lightman J pointing out:
- “[11] ...The House of Lords was unanimously of the view that the Court’s power to order payment to a co-owner of an occupation rent is no longer governed by the doctrine of equitable accounting but is instead governed by section 12 – 15 (and in particular the statutory principles laid down in section 15) of the 1996 Act...”
- “[14] ... **The wider ambit of relevant considerations means that the task of the Court must now be, not merely to do justice between the parties, but to do justice between the parties with due regard to the relevant statutory considerations and in particular (where applicable) the welfare of the minor, the interests of secured creditors and the circumstances and wishes of the beneficiaries specified.**”
15. In *Murphy v Gooch* the Court of Appeal allowed the non-occupying co-owner a credit for a notional occupation rent against the occupying co-owner’s credit for payment of the mortgage etc, each credit thereby cancelling each other out. The absence of any ouster of the non-occupying spouse was not decisive. The outcome under the statutory scheme of TLTA in *Murphy v Gooch* was to all intents and purposes exactly the same as if the case had been resolved under the “old” law of equitable accounting.
16. What is the position of a trustee in bankruptcy under the statutory regime of TLTA? This point was considered, perhaps for the first time, in the first instance decision set out below.

## **French v (1) Barcham (2) Walsh, Southend County Court per District Judge Chandler**

17. In very brief terms the District Judge held that:
- a trustee in bankruptcy was not entitled to occupy the property under the terms of section 12 of TLTA;
  - therefore a trustee in bankruptcy was not entitled to any compensation under section 13 of TLTA (i.e. notional occupation rent);
  - on the other hand the occupying owner was entitled to occupy the property under the terms of section 12 of TLTA, and therefore was entitled to compensation under section 13 of TLTA

Accordingly, in the circumstances of an entirely typical bankruptcy case the District Judge made an order giving the non-bankrupt spouse credit for one half of the mortgage instalments paid since the date of the bankruptcy order, the insurance premiums on the property, and the cost of works and improvements on the house, *without any countervailing credit in favour of the trustee in bankruptcy in respect of a notional occupation rent.*

18. The following extracts from the note of judgement indicate the reasoning of the District Judge:

“4. It is submitted that in *Byford v Butler Collins* J concluded that in circumstances like these the occupying co-owner of the bankrupt should have to account for a charge on the basis of equitable accounting, and on the basis that the justice of the case required that this should happen. He averted to the fact that when one party leaves the other in occupation, he will have to pay an occupation rent. But that is not a rule of law.

5. Collin J decided *Byford* by applying the principles of equitable accounting. This was reviewed in *Stack v Dowden* in the House of Lords, when Baroness Hale pointed out that parliament had legislated as to what would happen in these circumstances, and TLTA 1996 was now the authority under which the Courts would operate when considering these sorts of questions. The trustee submits that *Murphy v Gooch* approved of *Byford*, but it has to be remembered that *Byford* was an insolvency case and *Murphy* was not and the question of the particular position of the trustee in bankruptcy (applying TLTA) did not have to be considered by the Court of Appeal in *Murphy*. There is no third person in the shape of the trustee in the bankruptcy (or bankrupt) to consider.

6. Effectively the trustee asks for a payment of compensation under section 12 of TLTA to be imposed where the entitlement of another beneficiary to occupy under section 12 is excluded; then one may suppose a payment by way of compensation. Section 12 deals with the right to occupy and provides:

“(1) A beneficiary who is beneficially entitled to an interest in possession in land subject to a trust of land is entitled by reason of his interest in occupy the land at any time if at that time –

(a) the purposes of the trust include making the land available for his occupation (or the occupation of beneficiaries of a class of which he is a member or of beneficiaries in general), or  
(b) the land is held by the trustees so as to be so available

(2) Subsection (1) does not confer on a beneficiary a right to occupy land if it is neither unavailable or unsuitable for occupation by him.”

7. It is quite clear from section 12 that there is a distinction between possession and occupation because both words are used. **It is submitted by counsel for R2 that occupation requires physical possession, that it is not the purpose for the trustee to occupy, and that by virtue of his office the trustee cannot occupy the property as it is not suitable and trustee is not entitled to occupy it. Therefore the trustee has no right to compensation for exclusion or**

**restriction, as he has no right to occupy. These were not factors considered by *Byford* or *Murphy*.** That is R2's primary submission : the Court has no power to require R2 to pay compensation. As I hinted at before, it is suggested that *Murphy*, following *Stack v Dowden*, explains how TLTA is to be applied but TLTA didn't need to deal with the trustee in bankruptcy or how any claim might be dealt with. *Stack v Dowden* followed the decision in *Byford*. R2 submits that *Byford* is wrong because it goes too far, but that is really a secondary submission. The primary submission is that *Byford* was not made under TLTA provisions, as that was only identified as being relevant in *Stack* earlier this year.

**8. It is clear that section 12, whilst providing for a very wide discretion by a Court with jurisdiction, is a statutory regime and so the application must fall within it. A trustee in bankruptcy is not a beneficiary entitled to occupy land and is not therefore entitled to any compensation under section 13(6). Therefore I conclude the trustee's application must fail..."**

### **Wither Equitable Accounting?**

19. Is *French v (1) Barcham (2) Walsh* correct? This will be the subject of discussion and argument in the course of the seminar. The point will also be more authoritatively determined by the Court of Appeal in the forthcoming appeal by the trustee in *French*.
20. If *French* is correct i.e. that sections 12 to 15 of TLTA create a statutory regime that wholly replaces the former principles of equitable accounting then it may be that a right to occupy the subject property is the *sine qua non* of any right to an account. This means that not only will trustees in bankruptcy not be entitled to an account, but neither will other beneficiaries who are not entitled to occupy the property.
21. Furthermore the forthcoming appeal in *French* raises the enticing possibility that if *French* is wrong the Court of Appeal will take the opportunity to re-state the principles of equitable accounting, or in the absence of any wholesale re-statement of the law, at least put the law of equitable accounting in bankruptcy cases upon a firmer footing.

**Matthew Wales, Guildhall Chambers  
District Judge Julie Exton**

**April 2008**