THE EQUITY OF EXONERATION IN THE 21ST CENTURY

Paul French & Daisy Brown, Guildhall Chambers

1. Introduction
2. What it means
3. The principle in practice
4. Recent developments
5. Is there a future?

1. Introduction

1. The equitable principle known as the equity of exoneration is much misunderstood and misapplied. Indeed, in the modern world, there is a serious question as to whether it still applies at all in the majority of cases. Accordingly, having regard to a recent decision of Chief Registrar Baister, it is necessary to reconsider what it actually means and whether it should still apply.

2. What it means

2. The modern statement of general principle is found in the oft-quoted judgement of Scott J in *Re Pittortou* [1985] 1 WLR 58. However, its origins are much older, dating back to before the implementation of the Married Women's Property Act 1870, which first enabled married women to own property independently of their husbands:-

    2.1. In *Stamford, Spalding and Boston Banking Co v. Ball* (1862) 4 De GF & J 310, a wife's reversionary interest in personalty, held for her separate use, was assigned to trustees for a bank on trust to receive the same and retain and pay certain money due from her husband, there being no proviso for redemption or power of sale. It was held that the bank was not entitled to foreclosure but only to retain the money due from the husband when the wife's interest fell into possession.

    2.2. In *Earl of Huntingdon v. Countess Dowager Huntingdon* (1702) 2 Bro Parl Cas 1, the wife joined with the husband in mortgage of her freeholds of inheritance. The husband paid off the mortgage, and took an assignment of it in trust for himself. It was held that the wife's heir was entitled to the property as against the devisee of the husband.

    2.3. In *Pocock v. Lee* (1707) 2 Vern 604, the wife joined with the husband in a mortgage, the equity of redemption being reserved to husband and wife and their heirs. The husband having died, it was held that the mortgage must be discharged out of his estate in exoneration of that of the wife).

    It has to be said that, when considering whether the doctrine has any modern application, social conditions are rather different to when the principle was first operated.

3. In *Paget v. Paget* [1898] 1 Ch 470 a wife was entitled under a settlement to a life interest in property subject to a restraint from anticipation. She obtained from the Court, for the purpose of raising money to pay off her husband's debts, two orders under s. 39 of the Conveyancing and Law of Property Act 1881, charging her life interest with the sums of £23,000. and £22,000. She afterwards brought an action against her husband for a declaration that he was liable to indemnify her against the two charges created on her separate property for the payment of his debts, and the action was dismissed by Kekewich J.

4. On appeal, it was held that, under the circumstances of the case, no inference could be drawn in favour of the wife of any right to be indemnified by her husband, and the appeal was

dismissed. The doctrine that if a wife charged her separate property to pay her husband's debt she is prima facie regarded as lending, and not giving him the money raised, and as entitled to have the property exonerated by him, was purely equitable. It was based upon an inference to be drawn from the circumstances of each case, and there might be circumstances which prevented it from arising. So that until an inference in favour of the wife arose, there was no presumption for the husband to rebut. On the facts, she was "as extravagant and reckless as her husband, and was quite as desirous as he of maintaining her position in society. This object, so dear to both of them, might have been entirely frustrated if she had the right against him which she now asserts."

5. The decision in *Gee v. Liddell* [1913] 2 Ch 62 demonstrates that the scope of the doctrine is not limited to spouses, but operates as regards sureties in general. In that case, three family members (John, William and Walter) charged property as security for loans. About 75% was advanced to John, about 20% to William and the balance to Walter. The lender sought foreclosure, against William, without joining John and Walter. The principal issue was the identification of the necessary parties to the foreclosure action, but the doctrine was applied. The judgment made it clear that the doctrine was to be applied between co-mortgagors, and was not limited to husband and wife.

6. Similarly, and more recently, in *Re a Debtor (No 24 of 1971), ex p Marley v. Trustee of Property of Debtor* [1976] 1 WLR 952, the facts were as follows. In 1969 M, who wished to go into business on his own account, but was unable to raise the necessary money, approached his father and asked him to provide some security on which M could get a loan from his bank. The father agreed and, by a deed dated 17 December, conveyed the house in which he and his family lived into the joint names of himself and M on trust for sale and to hold the net proceeds of sale for himself and M as tenants in common in equal shares. In January 1970 the father and M executed a legal charge to the bank on the property to secure the overdraft of either of them, although the father had no account with the bank. M, having obtained the loan facilities from the bank, purchased premises and started a business, but it proved unsuccessful. M was adjudicated bankrupt on 24 June 1971 and on 14 July his trustee in bankruptcy was appointed. In January 1975 a dividend of 20p in the pound was paid to creditors, but a deficiency of £5,000 remained. On 30 July, on the application of the trustee, the county court judge directed that the house should be sold and that the net proceeds of sale, after repayment of the bank debt of £4,300, divided equally between the trustee and the father. The father appealed, contending that, as he was merely a surety for M's loan, the bank should be paid only out of M's, and not their joint, share.

7. It was held that as between the father and M, a provision should be implied that their intention was that M's beneficial interest was primarily liable for repayment. M's interest had accordingly vested in his trustee in bankruptcy subject to an inchoate right of indemnity, if the surety were called on to pay or the debt fell to be discharged out of the proceeds of sale. Alternatively, the father could be regarded as having an actual charge on M's interest. It followed that the bank's indebtedness was primarily payable out of M's half share of the proceeds of sale of the property. Accordingly, since the trustee's interest was minimal, the application would be adjourned to give the father an opportunity to come to some arrangement to purchase the trustee's interest.

8. In *Re Pittortou (a bankrupt), ex parte the trustee of the property of the bankrupt v. The bankrupt and another* [1985] 1 WLR 58, in 1979 the husband and wife purchased a home in their joint names using the proceeds of sale of their former matrimonial home (which had also been in their joint names). The new home was made subject to a first mortgage in respect of the balance of the purchase price and a second mortgage to the husband's bank to secure his indebtedness to the bank on an account which he used not only for his business but also for the payment of the joint household expenses. In 1981 he left the matrimonial home and went to live with another woman whom he was supporting. In 1982 he became bankrupt and subsequently his trustee in bankruptcy applied for an order for the sale of the matrimonial home and the division of the proceeds according to the shares in the property which the court declared the wife and the trustee to have. The question arose how, as between the trustee's share and the wife's share, the secured indebtedness on the husband's bank account should be met.

9. In principle, Scott J held that, applying *Paget* and *Marley*, where jointly owned property was charged to secure the debts of only one of the joint owners, then, under the equitable doctrine of exoneration and in the absence of evidence of the parties having a contrary intention, the other joint owner, being in the position of a surety, was entitled, not only as between the two joint owners but also as between himself and the creditor, to have the secured indebtedness discharged so far as possible out of the debtor's interest in the property, thereby enhancing the value of the other joint owner's share of the property.

10. However, applying that principle and having regard to the parties' intentions, the wife was entitled to insist that the husband's debts to the bank incurred in running the business and in supporting the other woman be met primarily out of his interest in the matrimonial home, since those debts were not the wife's debts. On the other hand, that part of the husband's debt to the bank which represented payments made by him for the benefit of the joint family expenses was a debt which fell on the property as a whole. Accordingly, the respective shares of the trustee in bankruptcy and the wife were dependent on the amounts of the husband's business and personal debts (which were deductible only from his share of the property) on the one hand and of the joint family debt (which were deductible from both parties' shares) on the other.

11. It is apposite to set out the oft-quoted passage at p.61, which is as follows:-

> "The [wife] is in the position of a surety, so far as her own proprietary interest in [the Property] is concerned. The bank's charge is a charge to secure her husband's indebtedness and not her own, but that indebtedness is secured on property of which she is, in part, the beneficial owner. As a general proposition, if there is found to be a charge on property jointly owned, to secure the debts of one only of the joint owners, the other joint owner, being in the position of a surety, is entitled, as between the two joint owners, to have the secured indebtedness discharged so far as possible out of the equitable interest of the debtor. The principle is expressed in *Halsbury's Laws of England*, 4th ed, vol 22 (1979), paras 1071 to 1076, under the general heading "Equity of Exoneration." The first part of paragraph 1071 reads:
>
> > "If the property of a married woman is mortgaged or charged in order to raise money for the payment of her husband's debts, or otherwise for his benefit, it is presumed, in the absence of evidence showing an intention to the contrary, that she meant to charge her property merely by way of security, and in such case she is in the position of surety, and is entitled to be indemnified by the husband, and to throw the debt primarily on his estate to the exoneration of her own."
>
> But the entitlement of the [wife] to be indemnified by her husband, the bankrupt, in respect of the debt owing to the National Westminster Bank that is charged on the matrimonial home, is a right of very little since he is bankrupt. A right which would be of real value to her would be the right to have the National Westminster Bank's indebtedness thrown primarily on his half share. That would have the effect of enhancing the size of her own proprietary beneficial interest in the property."

12. But, as the summary above makes clear, hat is not the end of what Scott J said; it is necessary to examine the facts. Hence, he continued at p.62, in a passage often overlooked:-

> "The present is a case in which, as is plain from the evidence, the family, until the sad departure of the bankrupt in 1981, acted as a family unit in its family and business affairs. The [wife] worked in the restaurants which the Pittortou family conducted, and which later the bankrupt on his own account conducted, for long hours and without pay. In that respect, her conduct was similar to the conduct of many wives assisting their husbands in the conduct of the business on which the livelihood and support of the family depend. In my view, payments made out of the bankrupt's National Westminster Bank account for the benefit of the family are of a character as to make it impossible to impute to the parties the intention that as between the husband and the wife the payments should be regarded as falling only on the share in the mortgaged property of the husband. In my

view the equity of exoneration should be confined to payments out of the account which do not have the character of payments made for the joint benefit of the household.

On the other hand, save for payments made for the joint benefit of the household, it does not seem to me that the equity of exoneration has any less part to play now than it had in the early days when the equitable doctrine was being formulated. Accordingly, payments made by the husband purely for business purposes and, a fortiori, any payments made by the husband for the purposes of the second establishment it seems he was supporting, should as between the bankrupt and the [wife] be treated as charged primarily on the bankrupt's half share in the mortgaged property.

In the notice of motion the trustee in bankruptcy asks, first, for a declaration as to the beneficial interests of the parties in [the Property]. In my judgment, the beneficial interests are these. To start with, when the property was purchased, the bankrupt and the [wife] were each entitled beneficially to a half-share subject to the building society mortgage. The second charge, securing the debt owing to the National Westminster Bank, secured a debt of the bankrupt; the debt was not a debt of the [wife]. Prima facie, therefore, in my judgment the equity of exoneration applies to entitle the [wife] to require that indebtedness to be met primarily out of the bankrupt's share in the net proceeds of sale. But to the extent that that indebtedness represents payments which can be shown to have been made by the bankrupt for the benefit of the household, the indebtedness should be discharged out of the proceeds of sale before division. There is no doubt that into that category will fall the building society instalments that were paid out of the National Westminster Bank account. Also, in my judgment, into that category would fall payments made for the purposes of the occupation of the property by the bankrupt and the [wife] and their daughter or otherwise for the benefit of the joint household.

The trustee, in my judgment rightly but in the circumstances with some generosity, does not seek to claim that any other payments than those to which I have already referred should be treated as coming out of the proceeds of sale before division. Any other payments accordingly will be treated as charged primarily on the bankrupt's half-share in the property."

13. The more up to date version of the commentary in *Halsbury's Laws* (5th edition) Vol. 73 para. 239, states as follows:-

"If the property of a spouse or a civil partner is mortgaged or charged in order to raise money for the payment of the other spouse or civil partner's debts, or otherwise for the other spouse or civil partner's benefit, it is presumed, in the absence of evidence showing an intention to the contrary, that the first spouse or civil partner meant to charge the property merely by way of security, and in such case that spouse or a civil partner is in the position of surety and is entitled to be indemnified by the other spouse or civil partner, and to throw the debt primarily on that person's estate to the exoneration of his own.

The right to exoneration is, however, a presumptive right only; it depends on the intention of the parties to be ascertained from all the circumstances of each particular case. It may be rebutted by evidence showing that the first spouse or civil partner intended to make a gift of the property to the other; and it has been held to be rebutted where the money was raised to pay debts which, though legally one party's, had been contracted by reason of the extravagant mode of living of both.

No presumption of a right to exoneration arises where the money is raised to discharge the debts or obligations of the party whose property is being mortgaged or charged, or otherwise for that person's benefit; and, where the mortgage of one spouse or civil partner's estate is contemporaneous with a settlement of it, the whole will be presumed to be one transaction so as to exclude that person's claim to indemnity, especially if the money is raised for the purpose of discharging any of their debts or charges on the estate, even though more money has been raised than is necessary for that purpose.

The court may order an inquiry as to which sums forming part of the money raised under the charge went solely to the benefit of the other spouse or civil partner, whether in their business or on their personal account, and which went for the benefit of the spouse or civil partner whose property has been mortgaged or charged, either solely or jointly with their spouse or civil partner or children; and, in respect of the latter sums, the spouse or civil partner whose property has been mortgaged or charged has no right of exoneration."

14. Finally, the principle has been considered abroad. On the issue of tangible benefit, the decision of the Federal Court of Australia in *Parsons and Parsons v. McBain* [2001] FCA 376 is particularly relevant. The court had to consider whether the indirect receipt of income into the household from the husband's business could be considered a "tangible benefit" to the wife with the effect of defeating her claim for exoneration. The trial judge considered it was, such that the right of exoneration was lost. The Court rejected this approach and allowed the wife's appeal, stating in relation to the principle and its application to the facts:-

"[18] … We can now consider each appellant's claim to ownership of the remaining half based upon the right of exoneration. The equity of exoneration is summarised in *Fisher & Lightwood's Law of Mortgage (*Aust. Ed., 1995) at par 30.7:

> "It is a well established principle that a person who has mortgaged his property to secure the debt of another stands only in the position of a surety and is entitled to be exonerated by the principal debtor. In this position is a wife who has mortgaged her property to secure money raised for the benefit of her husband. There is a similar equity in favour of a husband.
> Where the property of the wife, or property over which she has a power of appointment, is mortgaged, and the money is paid to her and her husband, or to him alone, it is considered prima facie that it was borrowed for his benefit, and his property is first applied, as for payment of his own debt, unless the presumption is rebutted by proof on the part of the husband, that the whole or some part of the money did not come to his hands. If the debt was not originally incurred for the benefit of the husband, this equity of exoneration does not arise by reason of his giving a covenant as additional security. The result will be the same, where the husband has paid off the mortgage, and has taken an assignment of it in trust for himself."

The authorities go back three centuries: *Huntington v. Huntington* (1702) 2 Vern 438; 23 ER 881; *Taite v. Austin* (1714) 1 P Wms 284; 24 ER 382; *Parteriche v. Powlet* (1742) 2 Atk 383; 26 ER 632; *Clinton v. Hooper* (1791) 3 Bro CC 201; 29 ER 490.

[19] It was once thought that this doctrine was limited to husband and wife. This appeared to be the view of Ashburner in his *Principles of Equity* (2nd ed, 1933) at p 170. In *Halsbury's Laws of England* (4th ed, 1979), exoneration is discussed only under the title concerned with husband and wife (Vol 22, pars 1071-1076). However the authorities show that the doctrine is not so limited, and will apply in other cases. That is what occurred in *Gee v. Liddell* [1913] 2 Ch 62 and *Caldwell v. Ridge Wholesale Acceptance Corporation (Australia) Limited* (1993) 6 BPR 13,539.

[20] The equity of exoneration is an incident of the relationship between surety and principal debtor. It usually arises where a person has mortgaged his property to secure the debt of another, whether or not that other has covenanted to pay the debt. However, it will also arise in a case where, although not an actual suretyship, the relationship is treated as one of suretyship. This is Lord Selbourne's third class of suretyship mentioned in *Duncan, Fox, & Co v. North and South Wales Bank* (1880) 6 App Cas 1, 10. For the doctrine to apply in this class, the following facts will usually exist. First, a person must charge his property. Where the person is the beneficial owner of the property it will be sufficient if the charge is by his trustee. Second, the charge must be for the purpose of raising money to pay the debts of another person or to otherwise benefit that other person. Third, the money so borrowed must be applied for that purpose. See generally *Re Berry (a bankrupt)* [1978] 2 NZLR 373.

[21] An equity of exoneration operates in the nature of "a charge upon the estate of the principal debtor by way of indemnity for the purpose of enforcing against that estate the right which [the beneficiary] has, as between [the beneficiary] and the principal debtor, to have that estate resorted to first for the payment of the debt": *Gee v. Liddell* [1913] 2 Ch D 62 at 72. Thus, where co-owners mortgage their property so that money can be borrowed for the benefit of one mortgagor, the other has an interest in the property of the co-mortgagor whose property is to be regarded as primarily liable to pay the debt.

[22] The trial judge denied to each appellant the right of exoneration because she had received "a tangible benefit" from the 1992 mortgage. The benefit, which might more accurately be described as an expected benefit, was that, by putting money into the partnership business, the business might survive and, as put by counsel for the trustee, that would bring "home money to put food on the table and clothe the children".

[23] If a surety receives a benefit from the loan, the equity of exoneration may be defeated. So, if the borrowed funds are applied to discharge the surety's debts, the surety could not claim exoneration, at least in respect of the benefit received. But the benefit must be from the loan itself. The question suggested by the Lord Chancellor of Ireland is: "Who got the money?": see *In re Kiely* (1857) Ir Ch Rep 394, 405. In *Paget v. Paget* [1898] 1 Ch 470 both the husband and the wife "got the money" and this prevented the wife claiming exoneration.

[24] The "tangible benefit" referred to by the trial judge will not defeat the equity. It is too remote. In any event, the exoneration to which a surety is entitled could hardly be defeated by a benefit which is incapable of valuation, and even if it were so capable, the value is unlikely to bear any relationship to the amount received by the principal debtor.

[25] Although each appellant is entitled to exoneration, that does not give her ownership of her husband's property, but merely a charge over it. It will therefore be necessary for each appellant to transfer a one half interest in the property to the trustee. He will then hold it subject to each appellant's charge. In any event, each appellant has the right to be subrogated to the mortgage over her husband's interest in accordance with cases such as *Banque Financière de la Cité v. Parc (Battersea) Ltd* [1999] 1 AC 221."

15. The principle was also considered by the Supreme Court of New South Wales in *Dickson v. Reidy* [2004] NSWSC 1200, where Nicholas J held:-

"[26] The equity of exoneration is conveniently explained in *Parsons v. McBain* (2002) 192 ALR 772 at p 779: [recites paras. [20] and [21] set out above].

(See also *Farrugia v. Official Receiver in Bankruptcy* (1982) 43 ALR 700 at p 702, and, relevantly, at p 703 where Deane, J held that the charge which Mrs Farrugia had upon her husband's interest in the property by way of indemnity to secure her right of exoneration was not obliterated by his bankruptcy, and that his interest which passed to the official receiver was subject to it).

[27] In *Official Trustee in Bankruptcy v. Citibank Savings Ltd* (1995) 38 NSWLR 116 Bryson, J at pp 129-130 observed that the doctrine of exoneration depends on the presumed intention of the parties and continues to exist to supply a presumption of the intention of parties as to who should be principal and who should be surety. He said (p 130):

> " … The doctrine serves to illustrate that the intention of a party may establish which is to stand as surety and which as principal even though both appear to incur substantially the same legal obligation.
>
> Although contemporaneous agreements, arrangements and expression of intention are the usual sources of evidence about the intentions of parties on such

a subject, there is no reason why their intentions may not be inferred from the circumstance in which they acted. Intentions, like other facts, may be proved from circumstances. Circumstances could conceivably furnish very clear proof of intention as to who was to be principal and who was to be surety, and the intended and actual application of funds raised when two persons incur a common liability would often have an important, even predominant part in the proof of the relevant intention".

[28] It is to be remembered that the doctrine of exoneration is based on an inference in each case from all the facts of that particular case. (*Hall v. Hall* (1911) 1 Ch. 487 at p 498)."

3. The principle in practice

16. From this emerges the following analysis:-

16.1. the wife/co-mortgagor must have joined in with a mortgage of the property;

16.2. the equity relies upon the presumed intention of the parties;

16.3. the wife/co-mortgagor must have done so for the purposes of the bankrupt or otherwise for his benefit; and

16.4. the money raised must have been applied for the purposes of the bankrupt or otherwise for his benefit.

17. The mechanics of how this works are demonstrated by the relatively recent decision in *Re Richards (a bankrupt); Bateman v. Williams* [2009] BPIR 478 and, on appeal, [2009] EWHC 1760 (Ch); [2009] BPIR 973. R and Mrs W were married, R being a builder. In 1986 he bought a plot in his sole name and by 1987 had spent £25,000 in building a house on it. In July 1987 R conveyed the property to himself and his wife as beneficial joint tenants and they charged it to a mortgage lender for £25,000. A month later there was a further charge to a bank to secure the debts of R. Both charges were discharged on a remortgage with a building society in November 1989 in the sum of nearly £75,000. R and Mrs W were divorced in 1990, notice of severance was served and shortly thereafter R was declared bankrupt with total unsecured liabilities of £150,000. Mrs W remarried but was divorced again some 10 years later, improvements having been made in the meantime. In 2001, Mrs W married W. Just after the marriage W redeemed the mortgage in the sum of £65,424 and the property was transferred to him. In May 2005 a trustee in bankruptcy was appointed and sought to realise R's share.

18. In relying upon the equity of exoneration, Mrs W sought to argue that it applied in respect of the building society mortgage, and that, at that point, Mrs W became entitled to the benefit of a fixed sum that she could enforce against the value of the trustee's interest in the property by way of set-off. At first instance, HHJ Jarman QC dealt with the point very shortly, having first referred to the older authorities, *Pittortou*, s.323 of the Act and *Stein v. Blake* [1996] 1 AC 243 as follows:-

"[37] It seems to me that I should first decide what the potential right to exoneration is. [The advocate for Mrs W] accepts that the costs of building the house should be deducted. Beyond that, the evidence is scarce. In my judgment, there is no distinction between that debt and the debt in relation to the purchase of the plot, as I find there most likely was. [Mrs W] accepted that her salary was modest and necessary for the second charge. She accepts that to some extent she was relying upon the business. It is likely, in my view, that there would have been costs of decoration and the provision of furniture for the family home. On the other hand, it is not the sort of case where her involvement in the family business was such as occurred in *Re Pittortou*. There were other assets on which she made claim but none were family assets. [Mrs W]'s evidence, which I accept, was that shortly after the 1989 loan was made, [R] left the home and did not pay

anything towards the building society borrowing for which she was still looking for him to support her. I accept that evidence.

[38] Doing the best I can, in my judgment, half of the sum advanced in 1989 was referable to [R]'s debts and that is a sum in respect of which the right to exoneration arises. In my judgment, this inchoate right of indemnity in respect of an accounting exercise which may have to be carried out if [Mrs W] is called upon to pay these debts or if they are discharged out of the proceeds of sale of the property, does not amount to mutual dealings envisaged by s 323.

[39] [Counsel for the trustee] accepted that that phrase is to be construed widely and may include contingent sums, but to say that it includes an inchoate right in respect of a beneficial interest in real property in my judgment is a step too far. The language used by Lord Hoffmann in *Stein v. Blake* and the language used in the section itself is not apt, in my judgment, to include such a right. It would be a startling proposition if a beneficial interest of a trustee in, for example, a former matrimonial home might be extinguished on the date of a bankruptcy on the basis of whether on that precise date there was equity in the property or not."

19. Mrs W got similarly short shrift from David Richards J on appeal. He held that whilst her exoneration claim, even though inchoate or contingent could fall within s 323 of the Act, such provision could have no application in this case as there was no liability due from R to her against which such claim could be set-off. The trust for sale of the property did not impose such liability but only an obligation on both owners to sell and distribute the proceeds of sale on the terms of the trust. Further, the trustee's claim did not involve the ascertainment of net indebtedness but was rather concerned with ascertaining the beneficial interests in the property. The notion of setting off the contingent liability to her against what had been R's beneficial interest in the property had no place in s.323 of the Act. Finally, in any event, for Mrs W's argument to succeed her claim would have to be fixed as equal to the value of R's interest as at the date of the bankruptcy and there was no possible basis for this (as to which, see also *Vidyarthi v. Clifford* [2004] EWHC 2084 (Ch); [2005] BPIR 233, where the wife was unable to fix the trustee with a value of the bankrupt's interest in the property in accordance with the value of the equity as at the date of the bankruptcy order).

20. What this makes absolutely clear is that, whatever the principle, whether in accordance with the English traditional approach or recognising that the "food on the table" argument is insufficiently close for a wife to benefit from a husband's charge for business purposes, it makes little difference when in fact there is little or no evidence as to how precisely the mortgage advance was actually applied.

4. Recent developments

21. Against this background, it is necessary to consider the recent decision of Chief Registrar Baister in *Re Chawda (in bankruptcy); (1) Lemon (2) Wood v. (1) Chawda (2) Chawda* [2014] BPIR 49.

22. C and his brother operated a partnership business. In May 1995 C and his wife purchased a property in Wembley with a mortgage with Lloyds. In about May 1998, the partnership business was transferred to a company, of which C and his brother were equal shareholders and each directors. In July 1999 C and his wife applied to Mortgage Express for a re-mortgage in the sum of £155,000. The stated purpose of the re-mortgage was "capital raising to purchase business property" and the outstanding existing mortgage was recorded as being in the sum of £74,659. Completion of the re-mortgage took place on 27 September 1999. The proceeds of the re-mortgage were used to redeem the Lloyds mortgage and, C and his wife asserted, the balance of £78,000 or so to purchase a property in Wealdstone. However C and his brother had already completed the purchase of the Wealdstone property some 3 months earlier, with it being held jointly by the two of them and Mrs C having no interest. In 2002, the Wealdstone property was converted and let out, and the rental income was paid to the two brothers. On 29 November 2002 C and his wife purchased a property in Harrow, which they occupied as their matrimonial home,

with the Wembley property let out. In July 2007 C and his brother re-financed the Wealdstone property, borrowing £306,400 from HSBC to do so. It was sold in November 2008 for £690,000, although £80,000 of the purchase price was not received until February 2009. In 2010 C got into financial difficulties. On 25 February 2011 C was served with a statutory demand by HMRC. A petition was presented on 7 April 2011. C's proposal for an individual voluntary arrangement was rejected at a meeting of creditors on 26 May 2011. A bankruptcy order was made against C on 3 November 2011, and the trustees in bankruptcy were appointed on 15 November 2011. By application dated 27 February 2013 the trustees sought seek declarations as to the ownership of, and an order for sale of, the Wembley property. C and Mrs C accepted that they each had a 50% interest in it, but Mrs C claimed that, pursuant to an agreement between her and C, she was entitled to an equity of exoneration in respect of the sum of £78,000 or so, representing that part of the proceeds of the Mortgage Express re-mortgage which she asserted was for C's sole benefit. The trustees asserted that for the equity to operate (a) the wife must have joined in a charge over jointly owned property; (b) she must have done so for the purposes of the husband; (c) the money must have been borrowed and applied for the benefit of the husband alone. They conceded that the first requirement was satisfied, but the others were not. Mrs C asserted that once the equity of exoneration had arisen it did not disappear, and that it was not good enough to take a broad brush approach and simply say that they were a family unit who lived well as a result of what the husband did.

23. Chief Registrar Baister granted the trustees' application, holding as follows:-

23.1. On the facts, there was no agreement between C and his wife as to the use of the Mortgage Express re-mortgage proceeds and how the Wealdstone property would be dealt with as regards repayment of the Mortgage Express mortgage.

23.2. There was a presumption that the equity of exoneration arose in the circumstances as asserted by the trustees, irrespective of the existence of an express agreement, but there could be circumstances which did not justify the inference, or indeed negated the inference. Quite apart from whether or not there was an agreement, there were circumstances in this case that negated the inference.

23.3. In circumstances in which a husband and wife operated by pooling their earnings and profits, administering their financial affairs jointly and enjoying together a prosperous life, it was as unattractive as it was artificial for one of them to take the benefits while at the same time seeking to enforce an individual right in one respect only to the disadvantage of the other spouse, or his creditors.

23.4. Therefore, Mrs C was not entitled to assert the equity of exoneration as against C's agreed 50% interest in the property.

24. Again, it is useful to set out the Chief Registrar's analysis of the facts, against the background of the general principles considered in *Paget* and *Pittortou*. He stated as follows:-

> "[45] First, I doubt whether in fact there was an agreement of the kind contended for by Mrs Chawda. This is the aspect of Mr and Mrs Chawda's evidence which I do not accept. I think the reality is that this is something that was thought up once Mr and/or Mrs Chawda were alerted to the possibility of asserting the equity of exoneration. I say that because there is nothing in Mrs Chawda's evidence (or for that matter in Mr Chawda's evidence) to show that Mrs Chawda ever sought to enforce the agreement at times when it would have been appropriate to do so, namely (a) when 8 Ashley Gardens was re-mortgaged in November 2006 and/or (b) when 31 High Street was re-mortgaged in July 2007 or (c) when 31 High Street was actually sold (the most obvious time, perhaps, to seek repayment). When [Counsel for the trustees] asked Mrs Chawda whether there were ever any discussions about paying what was due to her she said there were but that the matter was "brushed under the carpet". I do not accept that evidence. I am reinforced in my view that it is unlikely that there was an agreement by what I have said above about Mr Chawda's proposal for an individual voluntary arrangement. Query, in any event, whether, even if there has been an agreement of the kind contended for, Mrs

Chawda was really making a loan so that she would have simply been an unsecured creditor, but I shall say no more as this was not a matter explored at trial.

[46] As *Re Pittortou* makes clear there is a presumption that the equity of exoneration arises in the circumstances described, irrespective of the existence of an express agreement (see the *Halsbury* passage cited by Scott J *supra*). However, there can be circumstances which "do not justify the inference, or indeed…negate the inference".

[47] It seems to me that, quite apart from the question as to whether or not there was an agreement, there are circumstances in this case that negate the inference. The transactions which I have outlined above have to been seen in the context of the Chawdas functioning as a family unit as many, perhaps even most, modern families do. (I note here the relevance of changing social conditions mentioned by Walton J in the passage from *Hall v. Hall* cited by Scott J in *Re Pittortou*.) Mrs Chawda herself confirmed in general terms that she and her husband operated as a single unit. When discussing her and her husband's affairs, on more than one occasion she used the first person plural forms, "we" and "us". That the Chawdas operated as one is also clear from the following factors: (a) Mrs Chawda worked for Lexus Telecommunications Limited, initially without pay for seven days a week (in her own words) but later for a salary; later, as we have seen, she became a nominee director of Silverback Entertainment Limited for the benefit of her husband and herself; (b) Mr and Mrs Chawda operated joint accounts (neither of them had an account in sole name), joint credit cards, jointly received the rent from premises in Birmingham, in fact, as far as I can ascertain, received the totality of their income from all sources into joint accounts over which both had equal control; (c) as Mr and Mrs Chawda conceded, both of them effectively took the benefit of the ups and the downs of the husband's business ventures: like many couples both of them took the rough with the smooth; (d) both of them (indeed the whole family) enjoyed a prosperous life style, albeit not the extravagant life of the parties in *Paget v. Paget*; (e) even the Chawdas' son worked in the family business (although I accept that that is less significant and I am primarily concerned here with husband and wife).

[48] Towards the end of his cross-examination of Mrs Chawda [Counsel for the trustees] put to her specific benefits that she had enjoyed: a half share in 7 The Dell, the monies received by Silverback Entertainment Limited, the various other sums, the holidays the family had taken and so on. Mrs Chawda conceded that she had enjoyed those benefits. Leaving to one side the breakdown of the relationship, which was relevant in *Re Pittortou* but is not in this case, the parallels between the circumstances of the Chawda and the Pittortou families are clear.

[49] It seems to me that in circumstances in which a husband and wife operate as the Chawdas have, pooling their earnings and profits, administering their financial affairs jointly and enjoying together a prosperous life, if not an extravagant one such as that of the Pagets, it is as unattractive as it is artificial for one of them to take the benefits while at the same time seeking to enforce an individual right in one respect only to the disadvantage of the other spouse (or in this case his creditors). I illustrate the point by asking, how can it be right for Mrs Chawda to acquire an interest in a property worth just under £1 million with the benefit of £550,250 coming from one of her husband's businesses yet seek to have exonerated her equity in respect of another transaction from which she also benefitted both directly and indirectly? Common sense says that that cannot be right. Framed in legal terms, to do so, would, in my view, be wrong where the circumstances negate the presumption or inference on which she seeks to rely. The equity of exoneration is, as Scott J observed, a principle of equity. I should add that the point I make about the £550,250 applies equally to the money received from Silverback Entertainment Limited.

[50] I conclude, therefore, that the first respondent is not entitled to assert the equity of exoneration so as to marshal her claim against Mr Chawda's agreed 50% interest in the property. That, in my view, is consistent with the approach the courts took in both *Paget v. Paget* and *Re Pittortou*."

25. More recently, the equity of exoneration has been applied in a rather more commercial setting, without reference to the decision in *Chawda*. In *Day v. Shaw and another* [2014] EWHC 36 (Ch); [2014] BPIR forthcoming the defendants were a married couple, owing their home jointly. There were two charges on the property, the second to Barclays, as security for money loaned to a company, Avon. By the charge, Avon promised to pay to Barclays on demand all monies owed to Barclays, whether entered into solely or jointly as principal or surety. The defendants, as mortgagors, covenanted with Barclays to pay on demand all money owed by them. D1 was a director of Avon with the defendants' daughter (S), whereas D2 was not directly involved with it. D1 and S had also borrowed money from the claimant, who was not repaid when the debt fell due. Avon went into liquidation. The defendants negotiated with Barclays that when the property was sold, £70,000 would be paid from the proceeds to Barclays. The claimant obtained judgment against D1 and S. S was made bankrupt and the claimant obtained a final charging order against D1's interest in the property. The defendants sold the house and transferred the agreed sum Barclays. The claimant issued proceedings seeking to enforce the charging order, contending that the money transferred to Barclays was taken out of both defendants' share of the proceeds, and that the judgment debt should come out of D1's share of the remaining net proceeds. The defendants contended that D1 should indemnify D2, on the basis of the equity of exoneration, such that the liability under the second charge to Barclays would have fallen first on D1's share before any remaining balance was deducted from D2's share. Therefore, there would be nothing for the claimant's charging order to be enforced against, as D1's share would have been used up in paying Barclays. The district judge found for the defendants. The claimant appealed.

26. Morgan J dismissed the appeal, holding:-

    26.1. It was established law that a joint owner who was effectively in the position of a surety for the other joint owner was entitled to be indemnified by him in relation to the relevant debt.

    26.2. The right to an indemnity carried with it a proprietary right over the indemnifying party's share of the property.

    26.3. Hence, the party with the benefit of an equity of exoneration had not only a personal claim but was also a secured creditor in relation to that claim.

    26.4. Avon was the principal debtor in relation to the Barclays debt, and D1 and S owed a secondary liability under their joint and several guarantee, and both D1 and D2 had a secondary liability under the mortgage.

    26.5. Hence, D1 and S were sureties for Avon's debt, whereas D1 and D2 as mortgagors were sub-sureties, entitled to be indemnified by the sureties.

    26.6. Accordingly, for the purposes of the equity of exoneration, D2 had established that she was entitled to be indemnified by D1 in relation to the debt owed to Barclays.

    26.7. Therefore, D1, as one of two guarantors, was liable to indemnify D2, as one of the mortgagors, in relation to the debt owed to Barclays.

    26.8. D2's right to indemnity gave her a proprietary right in relation to D1's share, which had priority over the claimant's charging order.

5. Is there a future?

27. As demonstrated, the recent issues have concentrated on the "food on the table" element in a family/co-habitation scenario, and the question of what sort of tangible benefit from the transaction is required in order for the co-mortgagor not to be able to rely on the principle.

28. However, the analysis in *Chawda* changes the focus of the argument. Rather than looking at the direct or indirect nature of the proceeds of the loan, the decision widens the issue and looks at the totality of the facts from the point of view of rebutting the inference that the principle should apply. If the parties to the mortgage operate as a family unit, as most modern families do, then that will be a foundation for arguing that the fact of such indirect benefit shows that the inference does not apply, or negates it. From this perspective, it is very difficult to argue against the pithiness of the Chief Registrar's conclusion: if the wife indirectly benefits from the fruits of the mortgage in the good times, why should she not bear the burden of it in the bad times?

29. Therefore, when a wife asserts the principle against her husband's trustee in bankruptcy, the trustee should look for facts which go to the following issues:-

    29.1. Does the wife work for the husband's company/business?

    29.2. Do the husband and wife operate joint accounts or joint credit cards, neither of them having an account in their sole name?

    29.3. Do the husband and wife jointly pool investment income, however derived?

    29.4. Is there any degree of financial independence, or do the husband and the wife take the benefit of the ups and the downs of the husband's business ventures, taking the rough with the smooth?

    29.5. How prosperous was the lifestyle enjoyed by the family?

    29.6. Has any inference that the right might arise been abandoned by the wife's conduct?

30. The trustees' solicitors in their bulletin on *Chawda* concluded that "this ruling means that in the 21st Century, where it is commonplace for spouses to share their income and enjoy a lifestyle on the back of the other's business, there will now only be limited circumstances where exoneration will apply." That is probably a fair analysis. But it also demonstrates that there is life in the doctrine yet, outside the classic family situation. So, as in the older cases of *Gee v. Liddell* and *Marley*, where although the co-mortgagors were part of the same family, there was no family unit, there is no reason why the principle should not continue to apply. Similarly, it would seem that the equity would still apply in a rather more commercial environment, as demonstrated by *Day v. Shaw*.

Paul French & Daisy Brown
Guildhall Chambers
May 2014