



Exoneration a modern interpretation

What is the most common defence to a trustee in bankruptcy's application for an order for possession and sale?

Answer: Exoneration.

But does it work?

In this article we examine that question, the changing role of women and the approach adopted by the courts in such cases.

Exoneration is an equitable principle. It has been described in the following terms:-

"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".

Halsbury's Laws

From the above description it can be seen that it relates to married women and not co-habitees. It applies when money is raised to pay the husband's debts or otherwise used for his benefit. In such circumstances, its application is presumed in the absence of evidence to the contrary. It is only effective to transfer the married woman's liability under the charge or mortgage onto the husband's share of the property in the event that the husband has sufficient beneficial interest remaining in the property after discharge of prior secured liabilities. It cannot be used by the wife to avoid her liability under the mortgage or charge against the secured lender in the event that the husband's interest is insufficient.

Since the Insolvency Act 1986 came into force, the leading case on the equity of exoneration was **re Pittortou [1985] 1 All ER 285**. In that case Scott J explained that whilst the equity of exoneration is a principle which depends on the presumed intention of the parties, if the circumstances of a particular case do not justify the inference, or indeed the circumstances negate the inference, then it will not apply.

In **re Pittortou** the family business was running restaurants. The husband and wife executed a charge in favour of the bank to secure borrowings for the purpose of the restaurant. The monies were used for both the restaurant business and for the payment of expenses in connection with the matrimonial home. Subsequently the husband and wife divorced and the husband was adjudicated bankrupt.

In that case it was held that the equity of exoneration applied but in respect of payments which had been made for the benefit of the household, exoneration would not apply. This would include mortgage payments, payments made for the purpose of occupation by the family or otherwise for the benefit of the joint household.

The significance of **re Pittortou** was that the presumption or inference that the equity of exoneration applies may arise in circumstances irrespective of whether or not there is any express agreement. Even where the presumption arises, it may only apply to part of the monies secured by the charge. This may require a detailed examination as to the ultimate use of the funds raised from the lender in respect of which the wife seeks exoneration.

Re Pittortou also recognised the fact that where payments are made for the benefit of the joint household, then the equity of exoneration will not apply. The theme of the "joint household" was recently considered in the case of **Lemon & Wood v Chawda [2014] BPIR 49** and was developed in the context of modern relationships and family units.

In **re Chawda**, the matrimonial home was re-mortgaged, for the purpose of "capital raising to purchase a business property". When the husband subsequently went bankrupt, the wife claimed exoneration for the re-mortgage monies in the sum of £74,659 which were used to purchase an investment property held by the husband and his brother. In respect of that sum she claimed exoneration. By the time of the husband's bankruptcy, the matrimonial home had been let out and a further home had been purchased for the family to live in. The second home was purchased with the assistance of an advance from one of the husband's companies in the sum of £550,250. Prior to buying the new family home, the original



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investment property purchased by the bankrupt and his brother, had been sold at a substantial profit. No part of the £74,659 allegedly used towards the purchase of the investment property was repaid to the husband and his wife.

Changing role of women

In considering Mrs Chawda's claim, the Court referred to earlier Victorian authorities and the changing role of women within the family unit.

In **Paget v Paget [1898] 1 Ch 470** the wife sought to claim exoneration in respect of charges that she had given over her property to pay her husband's debts. On that occasion her claim failed because she had been extravagant and desirous of maintaining her position in society.

In the case of re **Woodstock (a bankrupt) unreported 19.11.1979** Walton J commented on the decision of **Hall v Hall [1911] 1 Ch 487**. He did not think that he had to consider whether that case was now good law in view of completely changed social conditions. That case was decided in the days;

"when the wife did nothing except sit at home and run the household and boss the servants about and the husband was expected to be, and indeed was, the provider. Times have now changed".

Walton J

In re **Pittortou**, Scott J noted that the parties had acted as a family unit in its family and business affairs in running the restaurant, with the wife assisting the husband in the conduct of the business, on which the livelihood and the support of the family depended. In re **Pittortou** the husband left the wife for another woman and was supporting the second woman's establishment. Monies used to support the second establishment were not for the joint benefit of the original family unit and as such the original wife was entitled to be exonerated in respect of such costs.

In deciding re **Chawda**, Chief Registrar Baister doubted whether there was any specific agreement to cast the burden of the re-mortgage onto the husband's share. Further, she had never sought to enforce that position even though she could have demanded that repayment be made when the investment property was sold.

The Chawdas functioned as a family unit as most modern families do. The family enjoyed the benefits of the ups and downs of the husband's business, and like many couples took the rough with the smooth. Notwithstanding that, they enjoyed a prosperous lifestyle. Where families pool their earnings and profits and administer their financial affairs jointly together and enjoy a prosperous life;

"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)".

In applying a modern interpretation, Mrs Chawda's claim for exoneration failed.

Day v Shaw [2014] EWHC 36 (Ch)

Whilst it is attractive to greet the decision in re **Chawda** as a modern evolution of the equity of exoneration, the decision in **Day v Shaw** could be regarded as a flashback to earlier times. Mr and Mrs Shaw jointly owned a property. They had taken out a second charge with Barclays Bank. The property had been sold and the sums due paid to Barclays. However, the remaining proceeds were being held by solicitors following proceedings brought by Mr Day. Mr Day was seeking to enforce a judgment with a charging order over Mr Shaw's share of the net sale proceeds of the property. However, Mrs Shaw was claiming that the monies secured by the second charge were monies in respect of which she was entitled to be exonerated, thereby placing the burden of the Barclay's charge onto Mr Shaw's share of the net sale proceeds. If Mrs Shaw was correct then there would be no remaining share of the net sale proceeds belonging to Mr Shaw over which Mr Day's charging order could bite.

At first instance it was found that the second charge in favour of Barclays was in respect of monies lent to Avon Independence Limited ("Avon"). This was a company which was run by Mr Shaw and the couples' daughter Mrs Shergold. Unfortunately the extent of Mrs Shaw's involvement in the company was never entirely clear. It was suggested that she may have been a shareholder. Similarly the question of whether or

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not Mr and Mrs Shaw jointly i.e. as a family unit, benefitted from the prosperity or otherwise of Avon was not developed.

Initially, the Deputy District Judge found that Mrs Shaw was entitled to be exonerated in respect of the charge in favour of Barclays. Mr Day appealed. His appeal centred on the identity of the principal debtor which was Avon and not Mr Shaw.

What followed was an overly complex analysis of the liability of the various parties. This included Mr Shaw and Mrs Shergold in their capacity as guarantors for monies lent to Avon by Barclays. Secondly there was the liability of Mr and Mrs Shaw under the mortgage that they had provided over their property in respect of the monies lent by Barclays to Avon.

Avon subsequently went into liquidation and Mrs Shergold was made bankrupt. This left the position as between Mr and Mrs Shaw. The result being that Mr Shaw could not deny his liability to indemnify Mrs Shaw and her claim therefore succeeded.

In his judgment, Mr Justice Morgan also considered the alternative i.e. where there had been no intervening guarantors. In such circumstances, he held that where the company was owned and controlled by the husband alone and the wife was persuaded to grant a charge to secure a debt of the company then, the husband would be liable to indemnify the wife in such circumstances. However, in reaching that view, this presupposes that the debts were not incurred for the joint benefit of Mr and Mrs Shaw. The Judge acknowledged there was uncertainty over the question of the ownership and control of Avon and the extent to which it provided a joint benefit to the family unit.

And the winner is?

Taken together these two decisions appear to contradict each other. Whilst **Day v Shaw** allows the equity of exoneration to get up off the canvas after **re Chawda**, this reprieve owes much to the fact that the arguments concerning any joint benefit to the family unit and the role of Mrs Shaw in Avon, were not fully developed at first instance or, considered in detail on appeal.

Day v Shaw was also unusual in that it did not involve bankruptcy as in the case of **re Chawda**. Bankruptcy is the surrounding framework in which exoneration arguments are most frequently encountered today, and is often used as a defence to a trustee in bankruptcy's claim for an order for possession and sale. The decision in **re Chawda** demonstrates the current evolution of the equity of exoneration in its modern incarnation and is most likely to form the basis of future decisions in this area.

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