



Exoneration

Developments from the court of appeal

For the first time since **Paget v Paget [1898] 1 Ch 470** the Court of Appeal has had to consider the equity of exoneration. The case of **Armstrong v Onyearu [2017] EWCA Civ 268** followed a number of earlier High Court decisions. In doing so it had to consider a novel point to determine whether or not an indirect benefit will be sufficient to deny a right of exoneration to a wife/co-habiting partner.

Exoneration – what is it?

The equity of exoneration has been variously described. Halsbury's laws contain a comprehensive definition of the equitable principle (which notably only refers to married women). The principle is more easily described by reference to an example. If a property is jointly owned by A and B and it is mortgaged to secure the debts of B only then A may be entitled to a charge over B's share of the property to the extent that B's debts are paid out of A's share.

The rights of women and others

Historically the equity of exoneration has been closely linked to the development of women's rights dating back to before the **Married Women's Property Act 1882**. This link has been reinforced by the fact that most of the decisions involving exoneration relate to the position of the wife, and more frequently in modern times, that of a co-habitee. Perhaps more fundamentally, the Court of Appeal recognised that the equity of exoneration is part of the law relating to sureties and whilst it is an incident of the relationship between surety and principal debtor it will also arise in a case where, although not an actual suretyship, the relationship is treated as one of suretyship. It therefore potentially applies in a number of different situations which include co-habiting couples, married or unmarried. It may also arise in the case of any joint owners of property.

In **Armstrong v Onyearu**, the Court of Appeal had to decide the question of the extent to which a co-owner may be denied the equity of exoneration where it is claimed that the co-owner received an indirect benefit from the debt secured on the property.

Armstrong v Onyearu – the facts

Mr. and Mrs. Onyearu were a married couple. Mr. Onyearu was a solicitor. The matrimonial home was registered in the sole name of Mr. Onyearu. Mr. Onyearu's practice got into financial difficulties and he obtained an overdraft facility from his bank secured under the all-monies charge originally granted to the bank to secure the loan used to purchase the property. Mr. Onyearu used the facility to pay debts of his practice totalling £131,642. The firm's finances worsened and eventually it closed. Mr. Onyearu was made bankrupt in March 2011.

Mr. Onyearu's trustee in bankruptcy applied for an order for the sale of the property. In the course of those proceedings, it was established that Mrs. Onyearu had a 50% beneficial interest in the property. At a subsequent directions hearing, the Deputy Registrar dismissed the application for an order for possession and sale on the grounds that Mrs. Onyearu was entitled to a charge on her husband's half-share in the property by way of exoneration in respect of the loan facility granted to Mr. Onyearu for his practice and that the charge exhausted Mr. Onyearu's beneficial half interest.

How the loan was used – an indirect benefit?

The trustee in bankruptcy argued that the equity of exoneration did not arise because although the loan facility was directly for the benefit of Mr. Onyearu only and was used to discharge his business debts, Mrs. Onyearu had obtained an indirect benefit as it enabled Mr. Onyearu to continue in practice and to apply his drawings in meeting the monthly interest payments on the original mortgage loan from the bank.

Following the dismissal of the trustee's application, the trustee appealed and that appeal was also dismissed. The trustee further appealed to the Court of Appeal on what was described as a novel point as to the application of the equity of exoneration. There being no previous English authority on the situation where a joint owner has received an indirect as opposed to a direct benefit.

Separate finances – shared living expenses

Mrs. Onyearu had her own employment which was nothing to do with her husband's practice. She paid for improvements to the property. They had separate bank accounts into which they paid their respective incomes. They both contributed to joint living expenses. Mr. Onyearu paid the interest payments on the mortgage whereas Mrs. Onyearu paid utility bills, Council Tax and all other household expenses. *Continues...*



Exoneration Developments from the court of appeal

The trustee's argument on appeal was that Mrs. Onyearu received a benefit from the loan to pay off her husband's business creditors because she and her husband operated as a "family unit" and the loan enabled Mr. Onyearu to continue in practice, and make payments under the mortgage loan.

In considering whether or not such an indirect benefit would be sufficient to deprive the co-owner of the equity of exoneration, the Court considered the earlier authorities.

Earlier authorities

In the case of **Paget v Paget [1898] 1Ch 470** the wife was described as "a lady of fortune". On two occasions the property was re-mortgaged to pay her husband's debts. Following separation, she sought a declaration that her husband was liable to indemnify her in respect of the mortgage under the equity of exoneration. In that case the Court held that the mortgage had been used to fund a prosperous life-style for both parties and maintain their position in society. As such her claim for exoneration failed.

In **Paget v Paget** the Court noted that the authorities on the doctrine of exoneration show that it is based on an inference to be drawn from the circumstances of each particular case, the prima facie inference being (in such a case as that supposed) that both parties intended that the wife's assistance should be limited to the necessity of the case only. In granting a charge over jointly owned property to secure the loan of the other party there is a presumption that the former is entitled to exoneration. This is an evidential presumption capable of rebuttal by evidence from which an action or inferred contrary intention can be drawn. It is, however, only a prima facie inference and the Court said that "there may be circumstances which prevent any inference from arising". In that case the Court concluded that the circumstances, namely that the parties intended to preserve her and his position in society, meant that that no prima facie inference could arise in favour of the wife and accordingly, there was no evidential presumption to rebut.

The best known authority on exoneration in modern times was the case of **Re Pittortou [1985] 1 WLR 58**. Mr. and Mrs. Pittortou ran a restaurant. They charged the matrimonial home to secure indebtedness to the bank for a loan which was to be used for purposes which included the business of the restaurant. The account into which the loan monies were paid was used by Mr. Pittortou for the restaurant business but also for paying household expenses, mortgage instalments utility bills, rates and other expenses. Towards the end of their relationship he also used monies in the account to support his new relationship. Mr. Pittortou subsequently went bankrupt and his trustee in bankruptcy was left arguing with Mrs. Pittortou as to the extent to which she was able to rely on the equity of exoneration in respect of the borrowings secured by the charge over the matrimonial home. In *Re Pittortou*, Scott J noted that the family "acted as a family unit in its family and business affairs". Mrs. Pittortou worked in the restaurant business on which the livelihood and support of the family depended. It was therefore impossible to impute to Mr. and Mrs. Pittortou the intention that payments out of his account "for the benefit of the family" should fall solely on his share of the property. As such it was held 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". As such Mrs. Pittortou was not able to claim exoneration in respect of mortgage payments, payments made for the purposes of occupation by the family or otherwise for the benefit of the joint household. She was however entitled to be exonerated in respect of payments made for the purposes of the restaurant business and in support of his second relationship.

Following *Re Pittortou* the position remained that the equity of exoneration applied to borrowings by one co-owner to fund his or her business even though the other co-owner might derive some indirect benefit from the business by way of contributions to joint living expenses from the business owner's income.

The Court of appeal then considered the more recent decision of **Re Chawda (in bankruptcy) [2014] BPIR 49**. In *Re Chawda*, the re-mortgage of the matrimonial home was used to purchase an investment property by the husband and his brother in which the wife had no involvement. Husband and wife enjoyed a prosperous life-style and Mrs. Chawda had worked in her husband's business. They did not have separate bank accounts but a joint account only. The monies originally borrowed under the charge used to purchase the investment property were not repaid on the sale of the investment property. In that case the Court concluded that the family operated as a "family unit" and enjoyed a prosperous life-style, accepting the ups and downs of the husband's business together. *Continues...*



Exoneration

Developments from the court of appeal

The circumstances of this particular case negated any inference that the equity of exoneration should apply in favour of Mrs. Chawda. A “family unit” and prosperous lifestyle equals “no exoneration”.

Despite the decision in *Re Chawda*, the Court of Appeal did not consider that that case represented a turning point in the law. Any impression that *Re Chawda* had in any way eroded the equity of exoneration was quickly dispelled by the following case of **Day v Shaw [2014] EWHC 36 (Ch)**. In that case Mr. and Mrs. Shaw had granted a second charge over their jointly owned matrimonial home to secure a personal guarantee given by their daughter and Mr. Shaw in respect of a bank loan to a company (Avon). Their daughter and Mr. Shaw were shareholders and directors of Avon. Mrs. Shaw had no involvement in Avon although she may have held some shares.

Following the sale of their home the liability to the bank was discharged out of the proceeds. A creditor then subsequently brought proceedings against Mr. Shaw to enforce a charging order. The question then was whether Mrs. Shaw was entitled to the equity of exoneration against Mr. Shaw's share of the property. The outcome of that case was that Mrs. Shaw was entitled to be indemnified by Mr. Shaw following the argument that as mortgagors they were sub-sureties for Mr. Shaw and their daughter and as such she was entitled to be indemnified by Mr. Shaw. In that case although it was argued at first instance, there was no evidence that Mrs. Shaw received any direct or indirect benefit from the borrowing in question.

In **Cadlock v Dunn [2015] BPIR 739** the wife agreed to charge her half share of the matrimonial home in order to raise a loan to enable the husband to re-acquire his half share from his trustee in bankruptcy. In that case the wife received no financial benefit, the only benefit to her being that she would stay in the matrimonial home which was incapable of any financial valuation. In that case the Court held that the equity of exoneration did apply.

More recently was the case of **Graham-York v York [2015] EWCA Civ 72** which involved an unmarried co-habiting couple where he was the sole registered proprietor. He died and she sought to claim a beneficial interest in the property and that that interest should have priority over the registered legal charge secured over the property. At first instance the Court found that she had 25% beneficial interest over which the charge took priority. Although the equity of exoneration was not actually pleaded at trial, it was considered by the Court on appeal. It was noted that the Judge at the earlier hearing had found that the husband's business was responsible for generating almost all of the income and assets that the family unit enjoyed and that the business had “provided us with the wherewithal to live on”. The Court held that the equity was not applicable where the family was wholly dependent upon Norton York's business venture for their income and assets.

No exoneration for joint account holders?

The *Graham-York* case also referred to a New Zealand Court of Appeal authority **Re Berry (a bankrupt) [1978] 2 NZLR 373** in the context of married couples and joint bank accounts. In that case a mortgage was secured over a jointly-owned house and the account was used for both the husband's business and for household purposes. Later the account became used largely for business purposes. Following the husband's bankruptcy it was held that the wife was not entitled to exoneration. The reason being that the account was a joint account and that the wife, as well as the husband, was liable to the bank as a primary debtor. In that case it was further held that, in the absence of any agreement between them that the husband should be the principal debtor, they were co-debtors to the bank and as such the wife could have no entitlement to seek exoneration against ‘B’ nor could there be any evidential presumption of such an entitlement.

In giving the leading judgment in the case of **Armstrong v Onyearu**, Lord Justice David Richards stated that the concept of operating as “one family unit” was not helpful, or even a usable test for the purposes of the equity of exoneration. He further held that any benefit that would disallow the equity of exoneration must be direct or closely connected to the secured indebtedness.

In **Armstrong v Onyearu** the indirect benefit was subject to a double contingency namely that the firm had to survive, and secondly it had to be profitable to enable payments to be made. For the equity of exoneration to apply, the intention of the parties must be inferred at the date of the transaction, at which point the indirect benefit that might accrue was “wholly uncertain and incapable of any valuation.” *Continues...*



Exoneration

Developments from the court of appeal

The benefits must be capable of carrying a financial value. The possible indirect benefit to Mrs. Onyearu was too remote to provide the basis for inferring or presuming that her intention was to bear the burden of the loan equally with her husband as such. Further they did not operate as a single unit financially each having their own bank accounts. They did share family expenses. In that case the indirect benefit that was argued by Mr. Onyearu's trustee in bankruptcy was not sufficient to deny Mrs. Onyearu the equity of exoneration in respect of the secured borrowings.

Conclusion

Following the decision in **Re Chawda** the equity of exoneration appeared to be in decline. As a concept its place in the modern world was doubted as households increasingly operate as "*family units*" which may comprise married or unmarried couples. The decision in **Day v Shaw** quickly checked any trend that may have been initiated by **Re Chawda**. The decision in **Armstrong v Onyearu** represents a development of the decision in **Re Pittortou**. In the earlier case it was held that exoneration may apply either in whole or in part to monies secured by a charge. This means that an examination must be undertaken to identify exactly what sums the parties seeking to rely on the equity may have benefited from before the equity will cease to apply. The Court of Appeal have refined that process by confirming that only sums where the co-owner has received a benefit which is direct or closely connected to the secured indebtedness will be sufficient to disallow any claim for exoneration, as enunciated in Lord Justice David Richards' judgement in the Armstrong case.

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