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Family Finance Flyer No 64

Equity of Exoneration – The Modern Application

- analysis of *Armstrong v Onyearu & Another* [2017] EWCA Civ 258

Introduction:

1. Once I mention Trustee in Bankruptcy – I can anticipate, like ITVs 'Take me Out', many family practitioners' lights going out. But as Paddy McGuinness might say (apologies in advance) – let the ratio see the decidendi!
2. Yes this case was an appeal in respect of a Trustee in Bankruptcy's claim that the W's interest in the family home was subject to a secured loan, which had been used for H's business – however, the Court of Appeal's analysis of the principle of the *equity of exoneration* and its modern application actually raises factors which will be of substantive importance in both cohabitation and financial remedy disputes where one party seeks to argue that a debt secured on joint property was essentially for the other party's sole benefit.

Facts:

2. In 2011, H, a solicitor, was declared bankrupt. In 2005, a bank loan had been secured by him against the house and its funds had been used to meet the H's

solicitor's practice liabilities. The Trustee in Bankruptcy sought an order for sale. The was in H's sole name, but the lower court found it to be held beneficially for the parties in equal shares.

3. The secured bank loan on the parties' home was an all monies charge in favour of the bank. The lower court found that whilst H had informed W of the loan, he did not seek her consent nor did the parties discuss how the loan was to be repaid -see para 13 of Judgment.

4. At that time, the parties already had five children and W was expecting their sixth and after purchase, H and W had equally contributed towards improvements costs to the property -see para 9 of Judgment.

5. They also held separate bank accounts, into which they paid their respective incomes contributing therefrom to their joint living expenses, with H paying the mortgage and W discharging the other household expenses and latterly the mortgage instalments when H hit financial problems. Their evidence was that their initial budgeting arrangement had enabled H to better meet the mortgage -see paras 10-12 of Judgment.

6. The lower courts had accepted that W did derive a benefit from the loan in the sense of H's practice income having paid the mortgage on the home, but rejected the Trustee's contention that the existence of a benefit and/or that the parties operated as a family unit was sufficient to deny W *the equity of exoneration* (see *Re Pittortou* [1985] 1 WLR 58). Pursuant to the equity of exoneration the parties had intended that the liability for the debt should be primarily met from H's property share -see para 14-16 of Judgment.

Court of Appeal Decision:

7. The question for the Court of Appeal was what effect an indirect benefit of a debt to a co-owner had on the application of the equity of exoneration. The Trustee argued that W had gained an indirect benefit from the loan because H's solicitors' practice had continued to provide a family income stream and, therefore, an intention could be presumed that the burden of the debt would be shared - so displacing the equity.

8. By unanimous determination, the Court of Appeal emphasised the continuing relevance of the equity of exoneration principle to contemporary circumstance. The Court confirmed it arose where property jointly owned by parties is charged to secure the debts of one of the parties only in circumstances where, by operation of the principle, the other party is or may be entitled to a charge over the first party's share in the property to enable the debt to be primarily discharged therefrom.

10. The Court readily acknowledged that the principle had applications beyond bankruptcy, whether dealing with cohabitee disputes or those between divorcing parties eg where a judgment creditor of one party seeks to enforce the judgment against a joint property (*Gee v Liddell* [1913] 2 Ch 62 and *Re a debtor (No 24 of*

1971); *Ex parte Marley v Trustee of the Property of the Debtor* [1976] 1 WLR 952) – see para 2 of Judgment.

11. The authorities established that the equity's application is a matter of the actual or presumed intention of the parties. If the actual intention is that the equity is to apply or, conversely, is not to apply, this determines the issue. In many cases, there is no evidence of actual intention, and the law will arrive at the parties' presumed intention from an examination of all the relevant circumstances.

12. Generally, the common touchstone is to determine whether the co-owner was intended to receive benefits from the debts secured on the property. The Court of Appeal therefore had to determine the nature of those benefits which would suffice and, in particular, the effect of any indirect benefits.

13. The Trustee contended that an indirect benefit gained by the other party from the secured debt would be sufficient to displace the principle – see para 21 of Judgment.

14. The Court stated (para 43 of Judgment) the following established principles in relation to the equity of exoneration (following *Re Pittortou*):-

i) First, where jointly-owned property is charged with the indebtedness of one of the joint owners, then an evidential presumption arises that the parties intended that, as between themselves, such liability fell on the debtor's share first.

ii) Second, the circumstances may be that this presumed intention does not arise at all, such as stated in *Paget's case*, where the borrowing by the husband was to repay debts incurred by the couple's joint lifestyle or where on the evidence the wife had for her own good reasons deliberately made provision for her husband's debts – there the debts of one co-owner in law, are in substance the debts of the other co-owner or of both jointly.

iii) Third, the presumed intention arising under i) above, which follows that in effect of a surety, may be rebutted by evidence of a different intention.

iv) Fourth, absent evidence of an actual contrary intention, evidence that the debt is incurred for the other's direct benefit will rebut the presumed intention.

v) Fifth, the historical position that household debts were ordinarily the responsibility of the husband, is no longer the case, as shown by *Re Pittortou* where the burden of borrowings by one joint owner to fund the ordinary living expenses of both co-owners is assumed to be shared equally between them.

vi) Sixth, the equity applies to borrowings by one co-owner to fund his or her business, even though the other co-owner may derive an indirect benefit from

the business, eg by contributions to joint living expenses from business income.

vii) Seventh, the intention of the parties is to be determined as at the time the charge is given, although subsequent events may be considered for the light they shed on what the intention was:

viii) Eighth, each case is fact sensitive as to whether the equity applies.

15. The Court of Appeal analysed a number of cases including decisions from abroad in which consideration of the equity of exoneration had arisen. In so doing, the Court determined that within the jurisdiction of England and Wales the existence or prospect of an indirect benefit by the surety spouse from the loan would not per se deny the operation of the principle (see para 60 of Judgment). Instead, the benefit derived must, to displace the principle, be directly or closely connected to the loan in question.

16. Hence, in *Parsons v McBain*, [2001] FCA 376, (the Australian Federal Court) the appellant wives were held entitled to the equity of exoneration as against the half shares of their husbands in their respective matrimonial homes. The husbands, as brothers, worked their parents' family transport business. It needed funds to stay afloat and each brother took out loans as a result secured in each case, with the consent of their wives, on their respective matrimonial homes. The loans paid existing creditors of the business – but the business still failed and the brothers were made bankrupt. In finding the wives entitled to the equity of exoneration, the Federal Court had found that the benefit must be from the loan itself. The benefit indirectly derived from the loan arrangement whereby 'food was put on the family table' was too remote and probably incapable of valuation and/or unlikely to bear any relationship to the amount received by the principal debtor.

17. The Court of Appeal found the Federal Court's decision very much in point in concluding any indirect benefit gained in that case an insufficient basis for any presumed intention of the parties to share the loan burden equally – see para 72 of Judgment.

18. The Court of Appeal resisted any suggestion that the equity of exoneration principle was outdated and that different presumptions applied to current relationships where parties operate as one unit. On the contrary, arrangements between couples whether cohabiting or married remained numerous in variety and the trend since the reforming legislation of 1870 within this jurisdiction had been to provide financial emancipation to women so as to keep their property and financial affairs separate where desired. The Court stated it was '*consistent with this trend that the law should continue to treat couples separately where one stands surety for the debt of the other, unless the circumstances or the evidence show otherwise*'. (see para 80 of Judgment).

19. The Court of Appeal rejected in these circumstances any suggestion that a court would merely look at all the circumstances of the relationship to decide what inference to draw in relation to the parties' intentions – consistency of approach as

guided by established principles of which the equity of exoneration was one, required otherwise. (see para 84 of Judgment).

20. The Trustee's contentions that the presumption of the equity in favour of W had been displaced were rejected for the following reasons:-

- The indirect benefit in question was far from certain to accrue, being subject to the double contingency of the survival of H's firm and of it being profitable;
- The inference of intention is that which was held at the date of the relevant loan transaction when the benefit prospect was wholly uncertain and incapable of valuation – such benefits contended for must be capable of a financial valuation;
- The loan purpose was to pay H's creditors – he and they were the principal beneficiaries of the arrangement;
- Any potential benefit to W was too remote to infer an intention by her at its inception to bear the loan equally with H
- At the date of the loan, any potential benefit to W was also incapable of valuation and unlikely to bear any relation to the amount of the loan;
- These parties did not operate as a single financial unit anyway - each retaining their own income / bank accounts / sharing different household bills. To deny W the equity of exoneration W would end up not only paying her share but H's also which could not be regarded as in accord with equitable principles.

Commentary:

21. In practice terms, hitherto the deployment of an argument based upon the equity of exoneration will have been a more natural submission to family practitioners within a cohabitation dispute than in a financial remedy application on divorce.

22. However, there are a number of instances where the ratio of this decision could assist, usually a wife, as the weaker financial party, to persuade a Court to exercise the equity in her favour. The most obvious is where the husband may have secured a loan against the family home for his business or for acquiring a separate investment during the marriage which has since failed or been disposed of. There will be others, for example, where such a loan has been used to buy into tax avoidance schemes which have subsequently been the subject of an adverse investigation by HMRC resulting in likely recovery, penalties and interest.

23. Whilst the primary legal title of the secured property would, as above, be in the husband's sole name, the Court under the s 25 exercise may find the beneficial title was shared between both parties and the secured debt at first instance equally a liability of both in those circumstances. The wife may maintain she knew little of the liability undertaken and was not privy to any discussion, whereas the husband may well argue that she gained the benefit from the transaction in making more monies available generally or in maintaining the business income for the family.

24. Clearly, the Court under the s 25 exercise will have a wide discretion to do what is fair between the parties, but it may assist the wife's submissions in the eventual distribution to retain more of the net equity available to argue that the cost of repayment of that particular debt should be borne primarily as between the parties by him and not her from his retained share under the established equity of exoneration principle.

Ashley Murray Chambers

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