Cadlock (The Trustee in Bankruptcy of Anthony Ivor Dunn) v Dunn and another

[2015] EWHC 1318 (Ch)

Chancery Division, Leeds District Registry

HHJ Behrens sitting as a Judge of the High Court in Leeds

13 May 2015

Andrew Vinson (instructed by Gateley LLP) for the Appellant

Fred Banning, Solicitor Advocate (instructed by Clarke Mairs LLP) for the First Respondent

The Second Respondent was not present at the hearing in circumstances described below.

Hearing date: 29th April 2015

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Approved Judgment

I direct that pursuant to CPR PD 39A para 6.1 no official shorthand note shall be taken of this Judgment and that copies of this version as handed down may be treated as authentic.

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Judge Behrens:

1 Introduction

1 This is an appeal by the Trustee against an order of DJ Morgan made in the Newcastle County Court on 15th January 2015. The application related to property known as 45 Beech Court, Ponteland Newcastle NE20 9NE (Title ND167441) (“the property”) which was occupied by Mr and Mrs Dunn as their matrimonial home.

2 On 8th January 2013 the Trustee made an application for a declaration that he and Mrs Dunn were beneficially entitled to the property in equal shares and for an order for sale. On 27th June 2013 DJ Pescod acceded to the application making an order for sale no sooner than 1st October 2013.

3 On 28th February 2014 a warrant for possession was issued and due for execution on 24th March 2014. After a procedural history which it is unnecessary to rehearse on 10th July 2014 Mrs Dunn made an application under s. 375 of the Insolvency Act 1986 (“the 1986 Act”) to set aside DJ Pescod’s order and for the warrant for possession to be vacated.

4 That application came before DJ Morgan on 24th October 2014. DJ Morgan handed down a written judgment on 22 December 2014. At a further hearing on 15th January 2015 DJ Morgan:

1. Declared that the second charge on the property be paid first from the interest in the property of the Trustee

2. Set aside the possession order and the warrant for possession but gave the Trustee permission to apply at such time as the values of the property and the legal charges are such as to entitle the Trustee to a portion of the proceeds of sale of the property.

5 On 5th February 2015 I granted the Trustee permission to appeal against DJ Morgan’s order.

6 It will be necessary to consider the grounds of appeal in more detail later in this judgment. However an important feature of the case is the fact that this is the second bankruptcy of Mr Dunn. Following the first bankruptcy Mr Dunn’s beneficial interest in the property became vested in his Trustee. Mr and Mrs Dunn borrowed more than £150,000 to re-acquire that beneficial interest from the Trustee and subsequently (albeit after the presentation of the second bankruptcy petition) executed a second charge in favour of the Lenders.

7 The central question which arises in this appeal is whether there is an equity of exoneration in favour of Mrs Dunn arising out of the re-acquisition of the Trustee’s interest. Mr Banning on behalf of Mrs Dunn submits that this is a classic case for the equity of exoneration to operate. Mr Vinson on behalf of the Trustee does not accept this. Adopting the arguments in the skeleton argument of Mr Mohyuddin, Mr Vinson submits that the charge was not made for the purposes of Mr Dunn and that the moneys were not applied for his benefit. He submits that there was here the preservation of the matrimonial home and that Mrs Dunn benefited from this. DJ Morgan agreed with Mr Banning and had no hesitation in holding that Mrs Dunn was entitled to an equity of exoneration.

8 This appeal was listed for hearing in Newcastle. For administrative reasons (namely the availability of Court room space) it was moved to Leeds on the day before the hearing. Although the Trustee and Mrs Dunn and their representatives were informed of the change of venue Mr Dunn was not so informed. Mr Dunn had not in fact attended the hearing before DJ Morgan and had shown little interest in the application. He had not filed any evidence or made any written submissions. However as a party he had a right to be present. In fact he attempted to exercise that right by attending Newcastle Combined Court Centre in due time for the hearing. Both Mr Vinson and Mr Banning invited me to continue without him. They pointed out that he had no direct interest in the application, that substantial costs would be incurred if I adjourned the application and that it was unlikely that he would be able to make any significant contribution to the legal argument.

9 I decided to accede to the application and continue to hear the appeal. However I made it clear that if Mr Dunn wished to make any submissions when he had read this draft judgment he would be given the opportunity to do so. I indicated that I would take those submissions into account before handing down the final judgment.

2 The facts

10 Although there is no real dispute as to the facts it is necessary to set them out in rather more detail than the brief summary in the introduction.

11 On 30th May 1985 the property was transferred into the joint names of Mr and Mrs Dunn. It is not in dispute that as a result of that transfer the presumption of joint beneficial ownership applied with the result that they were legal and beneficial joint tenants.

12 On 30th January 1997 Mr and Mrs Dunn executed a charge in favour of Hyde Park Mortgage Funding Ltd. As at the date of the hearing before DJ Morgan there was £126,849.21 outstanding and secured by that charge.

13 On 26th August 1998 Mr Dunn was adjudged bankrupt for the first time. Mr Cadlock was appointed as his Trustee on 3rd December 1998. As a result of the automatic discharge provisions then in force Mr Dunn was discharged from his first bankruptcy on 26th August 2001. It is not in dispute that the effect of the bankruptcy was to sever the beneficial joint tenancy and to vest Mr Dunn’s beneficial half share in the property in the Trustee. It is equally not in dispute that this was not affected by the discharge. A bankruptcy notice was registered against the property at HM Land Registry.

14 In July 2009 the Trustee agreed to release his interest in the property for £150,000. There are no documents which set out the agreement in detail. The Trustee has not exhibited any documents. Mrs Dunn relies on a witness statement from her solicitor – Susan Mairs. However Susan Mairs was not instructed in 2009 and her evidence is based on her reading of the file of Mrs Dunn’s former solicitors – Nauntons – who were the subject of an intervention by the SRA. That file is not in evidence. Mrs Mairs’s understanding of the position is contained in a letter she wrote to Gateley’s on 30th June 2014. In that letter she describes the transaction in the following way.

On 17 July 2009 your client agreed to transfer or release to Mr Dunn his interest in the property in exchange for payment of £150,000, payment to be made in two instalments with the first payment of £100,000 to be made by 1 September 2009.

15 On 27th August 2009 the sum of £100,000 was paid direct to the Trustee’s solicitor. A further £50,700 was paid on 16th February 2010. I was told that the additional £700 was paid because the second payment was late.

16 It is not in dispute that those funds were provided as loans from Colin Ford, Michael Ford, Roger Douglas and Linda Douglas (“the Lenders”). There is however no contemporaneous loan agreement recording the loans.

17 No document was executed by the Trustee to transfer his interest to Mr Dunn. He did, however, remove the bankruptcy notice registered at the Land Registry.

18 In the letter of 30th June 2014 Mrs Mairs summarises the effect of the transaction in the following way:

Our client’s interest in the property was identical both before and after the transaction. Mr Dunn acquired an undivided half interest in the property (subject to the first charge) as a result of the transaction. Your client in his capacity as Mr Dunn’s Trustee received £150,700.

19 I have to confess that during the course of the hearing I expressed doubts as to whether that was the correct analysis of the position. In the absence of a document vesting the Trustee’s half share solely in Mr Dunn it was not clear to me that it was a proper inference that it was so vested. It seemed to me that another possible inference was that as the half share had been acquired by monies borrowed jointly that it should be treated as having been acquired jointly. That would have resulted in Mrs Dunn having a three quarter share in the property.

20 However neither Mr Vinson nor Mr Banning wished to adopt my possible analysis. It was pointed out to me that the matter had been argued and decided by DJ Morgan on the basis that Mrs Mairs’s analysis was correct. Furthermore the documents which she had seen from Naunton’s file were not in evidence. Furthermore if there had been a challenge to her analysis further evidence might have been adduced from either the Trustee or Mrs Dunn.

21 In those circumstances, despite my doubts, I agree that the appropriate course is to determine this appeal on the basis that Mrs Mairs’s analysis is correct.

22 On 22nd November 2010 a second bankruptcy petition was presented by HMRC against Mr Dunn in the sum of approximately £170,000.

23 On 17th January 2011 Mr and Mrs Dunn executed a charge on the property in favour of the lenders. Under clause 7 the charge was security for the sums detailed in clause 9. In clause 9 the sum specified is:

£196,500 to be paid on or before 17th July 2011 and such sum will bear interest at the rate of 10% per annum from the date hereof to the date of actual payment.

24 The charge contains no breakdown of how the figure of £196,500 is computed. The charge was registered at the Land Registry on 12th April 2011.

25 On 4th March 2011 Mr and Mrs Dunn entered into a Loan Agreement with the Lenders. Under clause 1 the commencement date was defined as 18 August 2009. Clause 2 contained a recital in the following terms:

The Lender has previously loaned money to the Borrower and both parties now wish to record in writing the terms of the loans previously made. The Lender agreed to provide the Borrower with a Loan under the terms of this agreement as set out in Schedule 1

26 Under clause 5 interest was chargeable at 10% p.a calculated monthly on the balance outstanding from the commencement date. Clause 8 provides that the loan is secured by way of legal charge against the property. Schedule 1 sets out the basic terms – the amount of the loan (£196,500), the rate of interest (10%), the commencement date (18 August 2009) and the repayment date (17 July 2011).

27 There is no breakdown of the £196,500. Thus whilst there is evidence that the £150,000 was loaned in respect of the purchase of Mr Dunn’s half share from the Trustee, there is no evidence as to the remaining balance.

28 On 12th April 2011 Mr Dunn was adjudged bankrupt for the second time. On 21st July 2011 Mr Cadlock was again appointed as his trustee.

29 As at the date of the hearing before DJ Morgan the value of the property was taken to be between £400,000 and £450,000

3 The Judgment of DJ Morgan

30 In paragraphs 4 to 18 of his judgment DJ Morgan summarised the facts. In paragraphs 19 and 20 he set out ss 284 and 375 of the 1986 Act. In paragraph 21 he commented that but for any application of the doctrine of exoneration s 284 would prevail.

31 In paragraphs 24 to 33 and 52 and 53 he considered the equity of exoneration and concluded in paragraph 58 that Mrs Dunn was entitled to rely on it. In his view all 3 of the conditions identified in the decision of Registrar Baister in Re Chawda were satisfied. He also considered (in paragraph 57) it to be untenable that:

The whole of the burden of the borrowing to discharge [the Trustee’s] interest should be borne by the one person to receive no benefit (i.e. [Mrs Dunn]).

32 In paragraphs 33 to 51 he considered the discretion under section 375 of the 1986 Act to vary or rescind any order made in the exercise of the bankruptcy jurisdiction. That involved a detailed analysis of the history of the proceedings including allegations that the Trustee had not given the full picture to DJ Pescod and cross allegations that Mr and Mrs Dunn were treating the Trustee with contempt. As there is no appeal against DJ Morgan’s decision to review DJ Pescod’s decision it is not necessary to refer to this further.

4 Common Ground

33 A number of matters were common ground in the appeal before me.

1. As noted above it was common ground that the effect of the 2009 transaction was that the Trustee’s half share revested in Mr Dunn with the result that the property was then held by Mr and Mrs Dunn on trust for themselves as beneficial tenants in common in equal shares. It was also common ground that the purchase price for that half share was provided as a result of a joint loan to Mr and Mrs Dunn by the Lenders.

2. It was common ground that the legal charge executed by Mr and Mrs Dunn on 17th January 2011 was caught by the provisions of s 284 of the 1986 Act in that it was a disposition of property made after the presentation of the second bankruptcy petition. It was accordingly void unless ratified by the Court. There was no suggestion that such ratification should be made.

3. It was also common ground that the legal charge dated 17th January 2011 was effective to create an equitable charge of Mrs Dunn’s beneficial half share of the property in favour of the Lenders in respect of the whole of the outstanding debt. I was referred in particular to the decision of Judge Pelling QC in Bateman v Hyde [2009] BPIR 737 who in paragraph 13 had referred to Thames Guarantee v Campbell [1985] 1 QB 210. I respectfully agree with the views of Judge Pelling QC on this point.

34 Thus the central issue was whether Mrs Dunn was entitled to the benefit of the equity of exoneration.

5 The equity of exoneration

35 I was referred to 3 cases on the equity of exoneration – Re Pittortou [1985] 1 All ER 285; Day v Shaw [2014] EWHC 36 (Ch) and Re Chawda [2014] BPIR 49. Paragraphs 19 – 23 of Morgan J’s decision in Day contain a clear description of the relevant law. Rather than attempting my own description it is convenient simply to set it out in full.

19. I was referred to a number of passages in Halsbury’s Laws of England, 5th Ed., where the equity of exoneration is discussed. The subject is discussed, in particular, at vol. 5 (Bankruptcy and Personal Insolvency), para. 674, vol. 49 (Financial Services and Institutions), para. 1152 and vol. 72 (Matrimonial and Civil Partnership Law), paras. 239 - 242. The matter is described in essentially the same way in each place although the language differs somewhat. In volume 49 at para. 1152, the matter is described in this way:

“Mortgages and charges

A person who mortgages his property to secure the debt of another stands in the relation of guarantor towards the person whose debt is thus secured, and is entitled to be exonerated by the principal debtor. This principle also applies where jointly owned property is charged to secure the indebtedness of one co-owner.”

20. The law is described in a similar way in Fisher and Lightwood’s Law of Mortgage, 13th ed., at paras. 45.7:

“Mortgage for another’s debt

A person who has mortgaged his property to secure the debt of another is presumed in the absence of other evidence to be only a surety and is entitled to be exonerated by the principal debtor. The same is true where jointly-owned property is mortgaged to secure money raised for the benefit of one joint owner.”

21. The law was considered and applied by Scott J (as he then was) in re Pittortou [1985] 1 All ER 285 where a property jointly owned by husband and wife was charged to secure repayment of the husband’s overdraft at the bank. Scott J said at 288 c-f:

“It is, I think, clear that the effect of the equity of exoneration in a case such as this is indeed to enhance the proprietary interest of the surety/joint mortgagor and not simply to give the surety a personal right to an indemnity from the debtor who is the other joint mortgagor. *Re Cronmire, ex p Cronmire* [1901] 1 KB 480 establishes the entitlement of a wife, whose property has been charged to secure her husband's debts, to prove in his bankruptcy in respect of the indemnity which he owes her. A subsequent case, *Re a debtor (No 24 of 1971), ex p Marley (J) v Trustee of the property of the debtor* [1976] 2 All ER 1010, [1976] 1 WLR 952, establishes that in addition to the right to claim an indemnity the surety can claim an enhanced proprietary interest. In that case Foster J, with whose judgment Fox J agreed, said ([1976] 2 All ER 1010 at 1013, [1976] 1 WLR 952 at 955):

'As between the bankrupt's father and the bankrupt, and bearing in mind that the father is admittedly only a surety, it should be implied that their intention was that the bankrupt's beneficial interest should bear the burden. If that is so, it seems to me that the bankrupt's interest 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, as it would have to be, out of the proceeds of sale of the property. Alternatively, I think that the father could be regarded as having an actual charge on the bankrupt's interest within the principle discussed by Warrington J in *Gee v Liddell* [1913] 2 Ch 62 at 72 … '

However, the equity of exoneration is a principle of equity which depends on the presumed intention of the parties. If the circumstances of a particular case do not justify the inference, or indeed if the circumstances negate the inference, that it was the joint intention of the joint mortgagors that the burden of the secured indebtedness should fall primarily on the share of that of them who was the debtor, then that consequence will not follow. In *Paget v Paget* [1898] 1 Ch 470, [1895–9] All ER Rep 1150 the Court of Appeal so found in a case where the indebtedness had been incurred in order to finance the luxurious living of the family, and had been taken advantage of and had been to the benefit of both joint mortgagors, notwithstanding that it was in law the debt of only one of them. And Walton J in *Re Woodstock (a bankrupt)* (19 November 1979, unreported) drew attention in his judgment to the need for the courts, in considering how the equity of exoneration should work as between a husband and a wife, to take into account the relationship which husbands and wives bear, or ought to bear, to one another in their family affairs in current times. The guide that Victorian cases can provide to the inferences which should be drawn from the dealings with one another of husbands and wives today is often not very valuable. Walton J, commenting on *Hall v Hall* [1911] 1 Ch 487, said:

'I do not think I have to go into the interesting question whether that case is now good law in view of completely changed social conditions. It appears to me that 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, and I am very far from that if that case were to be heard on precisely the same facts tomorrow, the decision would necessarily be the same.' ”

22. The later discussion in Re Pittortou concerned the question as to what the result should be in relation to sums drawn by the husband from the bank and spent on household expenses and sums drawn and spent on the husband’s business or on other matters for the benefit of the husband. It was held that the wife was entitled to an equity of exoneration in relation to sums spent on the husband’s business and the other matters but not in relation to sums spent in relation to household expenses.

23. As Re Pittortou makes clear, the joint owner who is effectively in the position of a surety for the other joint owner is not only entitled to be indemnified by the other joint owner in relation to the relevant debt but the right to an indemnity carries with it a proprietary right over the indemnifying party’s share in the property. Thus, the party with the benefit of an equity of exoneration has not only a personal claim but is also a secured creditor in relation to that claim. This is significant as regards that person’s other creditors. It is pointed out in footnote 6 to Halsbury’s Laws, 5th ed., vol. 49, para. 1152 that there were dicta in some of the early cases on this subject suggesting that the right of exoneration should be postponed to the rights of other creditors but there is no support for this approach in later cases.

36 Re Chawda is a complicated decision on its facts and I do not think that much would be gained from analysing them in any great detail. Registrar Baister deals with the law in paragraphs 39 – 41 of his judgment which sets out a somewhat longer passage from Scott J’s judgment than that cited by Morgan J in Day. In paragraph 42 he set out the submissions of Counsel for the Trustee which were said to be derived from Re Pittortou:

(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.

37 Counsel for Mrs Chawda had submitted that once the equity of exoneration had arisen it could not disappear. It was not good enough to take a broad brush approach and to say that the Chawda’s were a family unit who lived well as a result of what the husband did.

38 In paragraph 44 of his judgment Registrar Baister accepted the submissions of Counsel for the Trustee and rejected those of Counsel for Mrs Chawda. It does not to my mind mean that he thereby necessarily accepted the submission of law in paragraph 42. This is especially so because his subsequent analysis related to the facts of that case.

39 Thus he rejected the submission that there was any agreement between them as to the use of the moneys which were said to give rise to the equity of exoneration. He held (referring to the judgment of Scott J) that the circumstances of the case negated the inference. In paragraph 47 he pointed out:

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 vHall* [1911] 1 Ch 487 cited by Scott J in *Re Pittortou*.) Mrs Chawda herself confirmed in general terms that she and her husband operated as a single unit.

40 Similarly in paragraph 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).

41 I cite these passages not because they have any relevance to the facts of the present case but because they demonstrate that Registrar Baister was not applying the test suggested by Counsel for the Trustee. Rather he was applying the approach of Scott J in Re Pittortou.

42 I propose to follow the same approach and to apply the approach of Scott J as explained by Morgan J in Day. It may be that there is little difference in the end result.

Discussion

43 For convenience I repeat the formulation of the law in Halsbury Laws:

A person who mortgages his property to secure the debt of another stands in the relation of guarantor towards the person whose debt is thus secured, and is entitled to be exonerated by the principal debtor. This principle also applies where jointly owned property is charged to secure the indebtedness of one co-owner.

44 It is not in dispute that Mrs Dunn has charged her equitable half share of the property. Thus the next question is whether this was to secure Mr Dunn’s debt. The primary purpose of the loan was to enable Mr Dunn to re-acquire his beneficial half share of the property. As DJ Morgan and Mr Banning pointed out Mrs Dunn obtained no financial benefit from the payment at all. It was used solely to acquire Mr Dunn’s half share in the property. This is not a case like Re Chawda where monies were spent on joint expenditure. In those circumstances it seems to me that the person primarily responsible for repaying the Lenders was Mr Dunn. In those circumstances Mrs Dunn has indeed charged her beneficial interest to secure the indebtedness of Mr Dunn.

45 Mr Vinson suggests that the equity of exoneration does not apply because Mrs Dunn has received a benefit from the transaction. She has avoided the sale of her home. If she had to sell her home she would have been involved in incidental expenses which she has saved.

46 It may be that this submission is based on the formulation of the test by Counsel for the Trustee in Re Chawda. In any event I do not accept it. The relevant question is whether the charge was to secure Mr Dunn’s debt. For the reasons I have given I think it was. The fact that Mrs Dunn was thereby enabled to remain in occupation does not seem to me to matter.

47 I am conscious, of course, that the equity of exoneration depends on the presumed intention of the parties and that the circumstances in a particular case may not justify the inference. That was, of course, the view of Registrar Baister in Re Chawda. To my mind, however there is nothing in the facts of this case to negate the inference and (in effect) show that Mrs Dunn was – in effect – making a gift to Mr Dunn.

48 It is clear from the later discussion in Re Pittortou that if any of the sums loaned are spent on joint or household expenditure or for the joint benefit of the parties then the equity of exoneration does not arise in respect of those sums. In this case the sum needed to acquire the Trustee’s interest was £150,700. Yet the charge was in the sum of £196,500. There is no explanation of how the £196,500 is made up and it is by no means clear that it is wholly referable to the moneys used to acquire Mr Dunn’s half share.

49 For my part therefore I would hold that DJ Morgan was correct to find that Mrs Dunn was entitled to the equity of exoneration but I would limit the equity of exoneration to the sums loaned in respect of the acquisition of Mr Dunn’s half share plus interest.

50 It is clear from paragraph 23 of Morgan J’s judgment in Day that Mrs Dunn is effectively in the position of a surety for Mr Dunn’s debt. She is not only entitled to be indemnified by Mr Dunn but she is also entitled to a proprietary right over Mr Dunn’s share of the property. It follows that DJ Morgan’s approach in respect of the order for sale was correct.

51 The precise terms of the order will be discussed at the resumed hearing after Mr Dunn has had the opportunity to comment on this decision. However subject to the minor amendment in relation to the extent of the equity of exoneration I would dismiss this appeal.