Michaelmas Term
[2013] UKSC 65
On appeal from: [2011] EWCA Civ 856

JUDGMENT

Szepietowski (nee Seery) (Appellant) *v* The National Crime Agency (formerly the Serious Organised Crime Agency) (Respondent)

before

Lord Neuberger, President
Lord Sumption
Lord Reed
Lord Carnwath
Lord Hughes

JUDGMENT GIVEN ON

23 October 2013

Heard on 15 July 2013

Appellant
Romie Tager QC
Kevin Pettican
Henry Webb
(Instructed by Devereaux Solicitors)

Respondent
Sarah Harman
Kate Selway

(Instructed by National Crime Agency Legal Department)

LORD NEUBERGER

Introductory

1. This appeal raises an issue as to the applicability of the equitable doctrine of marshalling. Lord Hoffmann explained the doctrine in characteristically pithy terms in *In re Bank of Credit and Commerce International SA (No 8)* [1998] AC 214, 230-231 as:

> "[A] principle for doing equity between two or more creditors, each of whom are owed debts by the same debtor, but one of whom can enforce his claim against more than one security or fund and the other can resort to only one. It gives the latter an equity to require that the first creditor satisfy himself (or be treated as having satisfied himself) so far as possible out of the security or fund to which the latter has no claim".

2. It is perhaps also worth setting out how Rose LJ explained the doctrine in the same case in the Court of Appeal [1996] Ch 245, 271:

> "The doctrine of marshalling applies where there are two creditors of the same debtor, each owed a different debt, one creditor (A) having two or more securities for the debt due to him and the other (B) having only one. B has the right to have the two securities marshalled so that both he and A are paid so far as possible. Thus if a debtor has two estates (Blackacre and Whiteacre) and mortgages both to A and afterwards mortgages Whiteacre only to B, B can have the two mortgages marshalled so that Blackacre can be made available to him if A chooses to enforce his security against Whiteacre. For the doctrine to apply there must be two debts owed by the same debtor to two different creditors."

3. The question in the present case is whether it is open to the respondent, the Serious Organised Crime Agency ("SOCA"), to invoke the doctrine so as to marshal a charge granted to the Royal Bank of Scotland ("RBS") over the home of Mrs Szepietowski and an investment property she owned, with a later charge granted to SOCA over the investment property alone, thereby enabling SOCA to look to Mrs Szepietowski's home to satisfy the sum secured by the second charge. (Pursuant to the Crime and Courts Act 2013, SOCA was replaced by the National

Crime Agency with effect from 7 October 2013, but it is more convenient to retain the nomenclature used in the parties' argument and most of the documentation in these proceedings).

The facts giving rise to the issue

The Settlement Deed

4. In 1999, Mr Szepietowski was one of two partners in a firm of solicitors which received a transfer of some US $2.5m which was alleged to represent the proceeds of drug trafficking (although it is right to record that neither Mr Szepietowski nor his wife has ever been charged with any offence, and they both deny any wrongdoing). In July 2005, the Assets Recovery Agency ("ARA", whose staff, assets and functions were transferred to SOCA in March 2008 pursuant to the Serious Crime Act 2007) obtained an interim receiving order over certain assets acquired with the US $2.5m. Three months later, the receiving order was extended to a number of other properties, which had allegedly been acquired with proceeds of mortgage fraud and with income concealed from Her Majesty's Revenue and Customs ("HMRC"). In November 2006, the ARA began civil proceedings against Mr and Mrs Szepietowski seeking to confiscate the various properties on the basis that the proceeds of crime could be followed into them, and they accordingly constituted recoverable property within the meaning of section 266 of the Proceeds of Crime Act 2002 ("the 2002 Act").

5. There were 20 properties in total, and they included (i) Ashford House, Weybridge ("Ashford House"), which was Mr and Mrs Szepietowski's home, (ii) 2 and 2a Thames Street, Walton on Thames ("Thames Street"), (iii) 3 and 5 Church Street, Esher ("Church Street"), (iv) 2, 4, and 6 Torrington Close, Claygate, and (v) 109 Hare Lane, Claygate (together "Claygate"). All these five properties were registered in the name of Mrs Szepietowski, and each of them was subject to an all monies charge in favour of RBS. The parties have treated RBS as having a single charge over the five properties ("the RBS Charge"), and I will do the same.

6. Mr and Mrs Szepietowski and the ARA settled the proceedings on terms contained in a consent order dated 16 January 2008, which stayed the ARA's claim save for the purpose of enforcing the terms of settlement. Those terms were contained in documents attached to the consent order. Most of the terms were in a Deed of Settlement ("the Settlement Deed") dated 15 January 2008, which included a schedule which had three annexes. Annexe A listed the 20 properties, and recorded the secured creditor of, the value of, the amount charged on, and the equity in, each property. Annexe B listed 13, and Annexe C a further two, of those

20 properties, with identical details plus the identity of the registered proprietor. (The figures in the Annexes were in fact somewhat historic, but nothing hangs on that for present purposes).

7. The general scheme of the arrangement embodied in the Settlement Deed was that the 13 properties in Annexe B were vested in the Trustee for Civil Recovery ("the Trustee") on behalf of the ARA, the Trustee was also to have the two properties in Annexe C vested in him, and the balance of the properties in Annexe A were to remain with their registered proprietors free of the receiving order. Any property so vested or retained was to be subject to any existing charges.

8. Clause 2.1 of the Settlement Deed provided that it was made "in full and final settlement of all of the [ARA's] claims against" Mr and Mrs Szepietowski "in relation to the properties and the other assets listed in Annexe A" and in relation to their tax liabilities. One of the properties listed in Annexe A (but not in Annexe B or C) was Ashford House, which was accordingly to revert to Mrs Szepietowski free of the receiving order. In Annexe A, Ashford House was recorded as having a value of £2.3m, and charged to The Mortgage Business plc ("TMB") and RBS for about £1.46m, but it is clear that this was only the amount outstanding to TMB. Ashford House was not in Annexe B or C.

9. By clause 3.1 of the Settlement Deed, Mr and Mrs Szepietowski agreed to vest in the Trustee the 13 "Transfer Properties" listed in Annexe B, and the two "Additional Properties" listed in Annexe C. The Transfer Properties included Thames Street and Church Street. They were recorded as valued at £570,000 and £785,000 respectively, and (together with the Additional Properties) as (i) charged to RBS for a debt of about £3.225m and (ii) having equity of about £1.6m. Annexe C contained the two Claygate properties, at Torrington Close and Hare Lane, which were recorded as valued at £2.67m and £800,000 respectively, and, together with Thames Street and Church Street, as charged to RBS for a debt of about £3.225m, and having equity of about £1.6m.

10. The valuations of the Additional Properties, ie of Claygate, in Annexe C suggested that the liability to RBS could be fully met from their sale, and indeed the parties anticipated that the ARA would, in effect, be able to realise the Transfer Properties free of any liability to RBS. They recorded at the end of Annexe B that this would have enabled the ARA to recover just over £5.4m from the sale of the Transfer Properties after clearing all mortgages thereon.

11. At the time of the settlement, Mrs Szepietowski was negotiating to sell the Additional, Claygate, Properties, and clauses 4.1-4.3 of the Settlement Deed enabled and required her to proceed with the proposed sale. If she had not

bindingly agreed to dispose of Claygate within six months, then, by clause 4.4, she had to elect whether Claygate should remain vested in the Trustee, who would be free to dispose of them, or be transferred to her by the Trustee.

12. Clause 4.5 of the Settlement Deed is of some importance for present purposes, and it was in these terms (with paragraphs added for convenience):

> "(i) If the Trustee wishes to sell [Thames Street and Church Street] ("the Remaining RBS properties") before the Additional [Claygate] Properties are sold then [Mr and Mrs Szepietowski] agree that, if [RBS] consent, the [RBS Charge] over these properties and the Additional Properties in favour of [RBS] … shall be transferred to the Additional Properties only.
>
> (ii) If [RBS] does not so consent then [Mrs] Szepietowski will grant a charge to the Trustee … for the sums paid by the Trustee to [RBS] from the sale proceeds of the Remaining RBS properties".

13. Clause 4.6 of the Settlement Deed contained an agreement that "the total funds from the sale of the Additional Properties [would] be used in priority to the funds from the sale of the Remaining RBS Properties [ie Thames Street and Church Street] in satisfaction of the [RBS] Charge". Clause 4.7 provided that, on the sale of Claygate, the proceeds would be used to pay off what was owing under the RBS Charge insofar as it was registered against those properties, and any balance would be "fully accounted for by the Trustee to [Mrs] Szepietowski without deduction or set off".

14. The Settlement Deed contained a number of other provisions (including, in clause 13.4 an obligation on Mr and Mrs Szepietowski each to pay HMRC £687,500 in respect of back tax and national insurance payments in respect of the 14 tax years ending 2006/2007), but it is unnecessary to refer to them for present purposes.

Subsequent events

15. Towards the end of January 2008, Church Street, Thames Street and Claygate were duly vested in the Trustee, subject to the RBS Charge. However, the sale of Claygate did not proceed as anticipated. The Trustee implemented clause 4.5(i) of the Settlement Deed, and marketed Church Street and Thames Street, which were sold in April 2008 for £715,000 and £560,000 respectively. RBS declined to release them from the RBS charge, and consequently the proceeds of

sale were paid over to RBS. It was becoming clear that the sum likely to be realised on the sale of Claygate (when added to the proceeds of sale of Church Street and Thames Street) would scarcely be sufficient to clear the RBS Charge. This state of affairs was in marked contrast to the common expectation of the parties at the time of the settlement, when they had anticipated that the proceeds of sale of Claygate alone (estimated in Annexes A and C to be worth around £3.54m) would be sufficient to clear the debt to RBS (recorded in the Annexes as being about £3.225m).

16. A dispute then arose as to the properties over which Mrs Szepietowski was obliged to grant SOCA (who had by now replaced the ARA and the Trustee) a charge pursuant to clause 4.5(ii) of the Settlement Deed. In March 2009, Henderson J decided that the charge was to be over Claygate as Mrs Szepietowski contended, and not over Ashford House as well, as SOCA argued: – [2009] EWHC 655 (Ch). At that hearing, Mrs Szepietowski made it clear that she wished Claygate to be vested in her pursuant to her obligation to elect in clause 4.4 of the Settlement Deed – see para 35 of the judgment. Accordingly, as he recorded in the following paragraph, Henderson J ordered that Claygate be re-transferred by the Trustee to Mrs Szepietowski, and that she grant a charge over them to SOCA.

17. Claygate was duly revested in Mrs Szepietowski on 4 September 2009, and on the same day she granted a charge over Claygate to SOCA ("the 2009 Charge").

18. Clause 1 of the 2009 Charge was concerned with interpretation, and included a definition of "Secured Amount" as being just over £1.24m, together with any sums due to SOCA under its terms. The figure of £1.24m was equal to the net proceeds of sale of Thames Street and Church Street, which had been paid in full to RBS under the RBS Charge, but which SOCA and the Szepietowskis had hoped would be paid to SOCA under clause 4.5(i) of the Settlement Deed.

19. Clause 2 of the 2009 Charge was headed "Covenants", and clause 2.1 was a covenant by Mrs Szepietowski that "on completion of any sale of the Charged Property effected by her", after paying the costs of sale, she would "apply the proceeds of sale … in settlement of the Secured Amount". Clause 2 also contained provisions which sought to ensure that any such sale would be effected at the best price.

20. Clause 3 of the 2009 Charge was headed "Charges", and, under it, Mrs Szepietowski charged the Charged Property and the proceeds of sale thereof "by way of legal mortgage" to SOCA as "continuing security for the settlement of the Secured Amount". Clause 7.1 provided that the Secured Amount "shall become

due and the security conferred by this Charge will become immediately enforceable and the power of sale and other powers conferred by section 101 of the Law of Property Act 1925 … will be immediately exercisable" after four months or, if earlier, on any breach of the 2009 Charge by Mrs Szepietowski, or her death or insolvency. Clause 7.2 provided that "for the avoidance of doubt", clause 7.1 did not "constitute a covenant by [Mrs Szepietowski] to pay the Secured Amount to [SOCA]".

21. Around December 2009, Mrs Szepietowski sold Claygate for a total of £2.33m, substantially less than had been anticipated two years earlier. The 2009 Charge was, of course, a second charge over Claygate, as it was still subject to the RBS Charge, and when the net proceeds of sale of Claygate were used to pay off RBS pursuant to the RBS charge, the relatively derisory figure of £1,324.16 was all that was left to satisfy SOCA's rights under the 2009 Charge.

SOCA's marshalling claim

The competing contentions

22. SOCA's case is that the classic requirements of marshalling are satisfied in the present case in light of the facts that:

i) Claygate and Ashford House were both owned by Mrs Szepietowski,

ii) Claygate and Ashford House were both subject to the RBS charge, which secured the moneys owing to RBS by Mr and Mrs Szepietowski,

iii) Claygate, but not Ashford House, was subject to the later 2009 Charge in favour of SOCA, which was a second mortgage which secured some £1.24m,

iv) RBS was repaid the debt owing to it out of the sale proceeds of Claygate, while Ashford House remains unsold, and

v) The £1.24m secured by the 2009 Charge remains unpaid (save to a minimal extent) despite the sale of Claygate.

Accordingly, SOCA contends that, as second mortgagee of Claygate, which was subject to a first mortgage, together with Ashford House, in favour of RBS, it is entitled to look to Ashford House in order to obtain payment of the sum which was secured by the 2009 Charge on Claygate, as the proceeds of sale of Claygate were used to pay off what was due to RBS.

23. Mrs Szepietowski's argument to the contrary has two strands. The first strand raises the contention that, in the light of the terms of the Settlement Deed and the 2009 Charge, SOCA's marshalling claim cannot be maintained. The second strand is that, even if marshalling could otherwise be justified, it cannot succeed, as the property against which SOCA's marshalling claim is focussed, namely Ashford House, is and was the home of Mrs Szepietowski, the mortgagor, whereas the property against which the RBS Charge was enforced is not and was never her home.

The decisions of the courts below

24. Henderson J held that SOCA's marshalling claim was well-founded and the Court of Appeal (Arden, Sullivan and Patten LJJ) agreed with him: – see [2010] EWHC 2570 (Ch) and [2011] EWCA Civ 856 respectively. The judgments in both courts concentrated on the first strand of Mrs Szepietowski's argument, and did not consider the second (because it was not raised).

25. Henderson J had held in his 2009 judgment [2009] EWHC 655 (Ch), that Ashford House was excluded from the ambit of the charge envisaged by clause 4.5(ii) of the Settlement Deed, in the light of the terms of the Settlement Deed, and in particular clauses 4.5 and 4.6. However, in his subsequent judgment, he concluded that there was nothing in the Settlement Deed or the 2009 Charge which expressly provided, or necessarily implied, that SOCA's right to marshal was to be excluded: – see [2010] EWHC 2570 (Ch), paras 27 and 37. In particular, he did not consider that clauses 4.5 and 4.6 of the Settlement Deed or the fact that there was no debt due to SOCA from Mrs Szepietowski under the 2009 Charge, precluded marshalling. He held that a debt due to SOCA arose from the creation of the charge, if not earlier, albeit one limited to satisfaction from the proceeds of the sale of Claygate - para 46. He also held that there was no other reason to deprive SOCA of its prima facie right to marshal – para 49.

26. The Court of Appeal, in a judgment given by Patten LJ, agreed, and approved the reasoning, as well as the conclusion, of the Judge, although, as is frequently the position, they did not focus on all the same arguments as the Judge. In particular, they concluded that clause 2.1 of the Settlement Deed did not preclude marshalling: – (see [2011] EWCA Civ 856, para 48), and that marshalling

was not precluded by the fact that it was SOCA and Mrs Szepietowski, rather than RBS, who decided to sell the Claygate properties, Thames Street and Church Street: – (see at para 52). Nor did the Court of Appeal consider that marshalling was precluded by the limited nature of the charge which Mrs Szepietowski gave, and the absence of any underlying obligation to pay the Secured Amount; that was treated as merely going to the discretion whether to exercise the equitable power to marshal: – (see at para 54).

27. Mrs Szepietowski now appeals to this court.

Marshalling: the principles

28. As Paul Ali explains in his monograph, *Marshalling of Securities: Equity and the Priority Ranking of Secured Debt* (1999), p 12, para 2.02, the earliest surviving references to marshalling appear to be in two late 17th century cases, *Bovey v Skipwith* (l671) 1 Ch Cas 201 and *Povye's Case* (1680) 2 Free 51. The principle was then considered in a number of 18th century cases, which Ali lists in footnote 6 on p 13.

29. A relatively early exposition of the law of marshalling may be found in the judgment of Lord Hardwicke LC in *Lanoy v Duke & Duchess of Atholl* (1742) 2 Atk 444, 446:

> "Is it not then the constant equity of this court that if a creditor has two funds, he shall take his satisfaction out of that fund upon which another creditor has no lien … . Suppose a person, who has two real estates, mortgages both to one person, and afterwards only one estate to a second mortgagee, who had no notice of the first; the court, in order to relieve the second mortgagee, have directed the first to take his satisfaction out of that estate only which is not in mortgage to the second mortgagee, if that is sufficient to satisfy the first mortgage, in order to make room for the second mortgagee, even though the estates descended to two different persons …".

30. It is also worth referring to the judgment of Lord Eldon LC in *Aldrich v Cooper* (1803) 8 Ves Jun 382, 395, where he postulated a case where:

> "two estates [were] mortgaged to A; and one of them mortgaged to B. He has no claim under the deed upon the other estate. It may be so constructed that he could not affect that estate after the death of the mortgagor. But it is the ordinary case to say a person having two

> funds shall not by his election disappoint the party having only one fund; and equity, to satisfy both, will throw him, who has two funds, upon that, which can be affected by him only; to the intent that the only fund, to which the other has access, may remain clear to him."

31. Marshalling has thus been allowed to a creditor, in a case where (i) his debt is secured by a second mortgage over property ("the common property"), (ii) the first mortgagee of the common property is also a creditor of the debtor, (iii) the first mortgagee also has security for his debt in the form of another property ("the other property") (iv) the first mortgagee has been repaid from the proceeds of sale of the common property, (v) the second mortgagee's debt remains unpaid, and (vi) the proceeds of sale of the other property are not needed (at least in full) to repay the first mortgagee's debt. In such a case, the second mortgagee can look to the other property to satisfy the debt owed to him.

32. Consider a case where the mortgagor owes £2m to the first mortgagee and £2m to the second mortgagee, the common property and the other property are each worth £3m, and the common property is sold, resulting in repayment in full of the first mortgagee and a reduction of £1m in the debt of the second mortgagee. The mortgagor still owes £1m to the second mortgagee, whether or not the second mortgagee can marshal. The only effect of the second mortgagee being able to marshal would be that it could directly enforce its outstanding £1m debt against the other property rather than falling back on the status of unsecured creditor. This emphasises the point that marshalling only really comes into its own where the mortgagor/debtor is insolvent: marshalling improves the position of the second mortgagee as against the unsecured creditors of the debtor, not as against the debtor herself.

33. Of course, the fact that the second mortgagee could proceed directly against the other property, without the need for a judgment and a charging order, is a minor disadvantage to the mortgagor of the second mortgagee being able to marshal. But Ali is correct in his statement (*op cit* para 4.48) that, at least in the cases where it has been held to apply, "Marshalling is neutral in its impact upon the residue available to the debtor following the discharge of its creditors' claims".

34. At one time judges expressed themselves in a way which suggested that a second mortgagee with the right to marshal could compel the first mortgagee to sell the other property to pay off the debt he was owed before having recourse to the common property. Indeed, Lord Eldon LC referred to the second mortgagee "ha[ving] a right in equity to compel" the first mortgagee "to resort to the other" in *Aldrich v Cooper* 8 Ves Jr 382, 388. However, it soon became well established that the first mortgagee had the right to have recourse to "any of his securities which first come to hand" and to "realis[e] his securities in such manner and order

as he thinks fit": – per Wood V-C in *Wallis v Woodyear* (1855) 2 Jur (NS) 179, 180, and Parker J in *Manks v Whiteley* [1911] 2 Ch 448, 466 respectively.

35. The principle behind the doctrine of marshalling has been identified by Story in his *Commentaries on Equity Jurisprudence*, 2nd ed (1892), pp 416-417, in these rather broad terms:

> "The reason is obvious ... [By] compelling [the first creditor with the two securities] to take satisfaction out of one of the funds no injustice is done to him ... . But it is the only way by which [the second creditor with one security] can receive payment. And natural justice requires, that one man should not be permitted from wantonness, or caprice, or rashness, to do an injury to another. In short we may here apply the common civil maxim: 'Sic utero tuo ut non alienum laedas'; and still more emphatically, the Christian maxim, 'Do unto others as you would they should do unto you'."

36. As I see it, there are also good practical reasons for equity adopting the doctrine, namely the unattractive and adventitious benefit which would otherwise be accorded to the first mortgagee. If marshalling was not available to the second mortgagee, the first mortgagee's free right to choose the property against which he enforced could have substantial value. In effect, he could auction that right as between the second mortgagee (who would be prepared to pay him to enforce against the other property) and the unsecured creditors of the mortgagor (who, especially where the mortgagor was actually or potentially insolvent, would be prepared to pay him to enforce against the common property). Further, it appears to be somewhat arbitrary that, if he could not marshal, a second mortgagee who had sufficient resources and was prepared to take any associated risk, could redeem the first mortgage (on the basis of "redeem up foreclose down" – see Megarry & Wade, *The Law of Real Property*, 8th ed, paras 25-110 to 113), and then protect its position as second mortgagee by selling the other property to redeem the first mortgage, before selling the common property.

37. So far as the limits of the applicability of the doctrine of marshalling are concerned, there are a number of cases where it has been held not to be applicable – eg because there is no common debtor or where a third party mortgagee may be prejudiced. However, we were taken to no case of specific relevance to the first strand of Mrs Szepietowski's argument. Guidance of a very general nature may, however, be found in what Lord Eldon LC said in *Ex p Kendall* (1811) 17 Ves 514, 527:

> "The equity is clear upon the authorities, that, if two funds of the debtor are liable to one creditor, and only one fund to another, the former shall be thrown upon that fund, to which the other cannot resort; in order that he may avail himself of his only security: where that can be done without injustice to the debtor or the creditor: but that principle has never been pressed to the effect of injustice to the common debtor…"

38. On the second strand of Mrs Szepietowski's argument, there is Australian authority to support the proposition that marshalling is not available to a second mortgagee where the first mortgagee is contractually bound to look first to the other property to satisfy the debt due to him – see *In re Holland* (1928) 28 SR (NSW) 369 and *Miles v Official Receiver* (1963) 109 CLR 501. This seems to me to be correct, at least where the contract is with the mortgagor or with someone else with an interest in the other property, because the basis of the right to marshal is the arbitrariness of allowing the first mortgagee's decision as to which asset to enforce against to affect the second mortgagee's rights. It also seems to me that the Australian cases accord with the approach of the Court of Appeal in *Webb v Smith* (1885) 30 Ch D 192.

The first strand of Mrs Szepietowski's argument

39. As the oral argument developed, it became apparent that the first strand of Mrs Szepietowski's argument as to why SOCA should be held to be unable to marshal involved two somewhat different contentions. Her first contention is that the simple fact that the 2009 Charge does not secure a debt from her to SOCA, or indeed any debt at all, means that there is no right in SOCA to marshal as it seeks to do. Alternatively, she contends that the provisions of the Settlement Deed and the 2009 Charge, coupled with the circumstances in which they were executed, demonstrate that marshalling is precluded. I shall take those two contentions in turn.

The absence of an underlying debt from Mrs Szepietowski to SOCA

40. The first contention raises a point on which we were told by both counsel that there is no authority. In all the cases (save in the so-called "surety exception" discussed by Ali, *op cit*, chapter 8) where marshalling has been allowed, both the first mortgagee and the second mortgagee have been creditors of the same debtor/mortgagor. However, in this case, at least according to her argument, Mrs Szepietowski never owed any money to SOCA - other than such sum, if any, as was payable to SOCA out of the proceeds of sale of Claygate after payment of all prior claims, and that sum has been paid to SOCA; indeed, according to her case,

the 2009 Charge does not secure a debt from anybody, other than that contingent sum.

41. Although that proposition was challenged by SOCA, I consider that it is correct. The terms of the Settlement Deed are concerned with the ownership of, and rights over, property, and not with creating or acknowledging debts (other than Mr and Mrs Szepietowski's debts to HMRC). And the 2009 Charge is notable for the absence of any provision which creates or acknowledges an obligation on Mrs Szepietowski, the mortgagor, to pay "the Secured Amount". All that she is obliged to do in relation to that sum under clause 2 is to use the proceeds of sale of Claygate towards settling it, after any prior obligations have been met. It is true that clause 7.1 refers to the Secured Amount "becom[ing] due", but it does not say from whom, and its language is readily explained by the terms of section 101 of the Law of Property Act 1925, to which it refers. In any event, SOCA's contention that the 2009 Charge secured a debt due from Mrs Szepietowski is given its quietus by the unambiguous terms of clause 7.2.

42. It therefore appears clear to me that the 2009 Charge did not create, or acknowledge the existence of, any debt from Mrs Szepietowski, or anyone else, to SOCA, save that it rendered her liable for a contingent debt, in that she was bound to pay SOCA an amount of up to £1.24m out of such sum, if any, as remained from the proceeds of sale of Claygate after the RBS Charge was paid off.

43. The notion that the 2009 Charge did not impose or acknowledge an obligation to pay the Secured Amount on the part of Mrs Szepietowski is also supported by (i) the fact that the Settlement Deed, from which it originates, did not impose such a duty, (ii) the terms of clause 4.5 of that Deed which provides for the 2009 Charge (a point dealt with more fully in para 69 below), and (iii) the fact that both the Settlement Deed and the 2009 Charge originated from proceedings under the 2002 Act, whose purpose is to recover specific properties not to recover a sum of money.

44. The fact that the 2009 Charge involved giving SOCA security over Claygate without an underlying debt being owed by the mortgagor (or anyone else), save the contingent debt identified in para 42 above, throws up an intriguing problem in relation to the right to marshal.

45. There is plainly a difference between marshalling in the normal case, where the mortgage to the second mortgagee is security for a debt due from the mortgagor to the second mortgagee, and marshalling in a case such as the present, where there is no underlying debt from the mortgagor (or anyone else) to the

second mortgagee (other than a contingent liability to pay a sum out of the net proceeds of sale of the common property).

46. As explained in paras 32-33 above, in the normal case, marshalling does not result in the liabilities of the mortgagor being increased after the sale of the common property. However, if the second mortgagee can marshal in a case such as this, where there is no underlying debt due to it from the mortgagor, the mortgagor's liabilities would be increased – at least once the common property has been sold by the first mortgagee. Thus, (i) if SOCA can marshal in this case, Ashford House would effectively be subject to a second mortgage (ranking after TMB's first mortgage – see para 8 above) securing just under £1.24m, and Mrs Szepietowski would have to pay that sum to SOCA or lose her home, whereas (ii) if SOCA cannot marshal, then Ashford House would be free of any second mortgage, and Mrs Szepietowski would be free of any further liability to SOCA.

47. We are therefore called on to decide whether, in a case where there is no underlying debt from the mortgagor to support the second mortgage (save the contingent debt described at the end of para 42 above), (i) the second mortgagee can invoke the doctrine of marshalling because the basis for its application, as described in paras 35 and 36 above, exists, or (ii) the second mortgagee should not be able to marshal as there is no underlying debt from the mortgagor to the second mortgagee after the sale of the common property and the distribution of its proceeds of sale, and there is a fundamental, if unspoken, requirement for the doctrine to be applicable that there is a debt owing to the second mortgagee at the time when he seeks to marshal.

48. I refer to the alleged requirement being unspoken, as there is no judgment which deals with this question, although many of the explanations of marshalling assume that the second mortgagee is owed an underlying debt by the mortgagor (for instance, the passages quoted from Lord Hoffmann and Rose LJ in paras 1 and 2 above refer to a debt owing to the second mortgagor), and other definitions do not (see per Lord Hardwicke LC and Lord Eldon LC in paras 29 and 30 above respectively). In the end, I do not find any these observations of assistance on this issue because they were all made in the context of cases where there was an underlying debt due from the mortgagor which was secured by the second mortgage. The judges concerned were simply not addressing their minds to the point at issue in this case.

49. I accept that it can fairly be said that the justification for marshalling, namely that the extent or value of the second mortgagee's rights should not depend on which of the first mortgagee's securities is realised first, and that the underlying reasons for marshalling identified in paras 35 and 36 above, apply in the present case. I also accept that the only difference between the result of marshalling in the

cases where it has been permitted and in the present case is the identity of the party who is prejudiced by the marshalling (namely the unsecured creditors in the previous cases, as against the debtor in the present case). Accordingly, I acknowledge the force of Lord Carnwath's reasoning in paras 101-104 below.

50. Nonetheless, despite Miss Harman's attractively developed argument to the contrary, I have concluded that as a matter of principle, marshalling is not available to a second mortgagee where, as here, the common property does not secure a debt due from the mortgagor, but is merely available as security for what the second mortgagee can extract from that property. My reasoning can be put in a number of different ways, but in the end they amount to much the same thing, namely that, in such a case, there is simply nothing, in particular no debt due from the mortgagor, from which the right to marshal can arise, once the common property has been sold and the proceeds of sale distributed in accordance with the legal priorities.

51. As already explained, the only debt which can be said to be due from the mortgagor to the second mortgagee in a case such as this is the sum (if any) which is left from the proceeds of sale of the common property after the costs of sale and the debt due to the first mortgagee have been paid off: – see clause 2.1 (supported by clause 7.2) of the 2009 Charge. Once that (admittedly derisory) sum was paid to SOCA, there was nothing due from Mrs Szepietowski (or anyone else) to SOCA, so it is difficult to see on what basis SOCA can say that it is entitled to enforce a right to be paid out of another property owned by Mrs Szepietowski.

52. It is one thing for a second mortgagee, who was a secured creditor of the mortgagor and has not been paid in full (or at all) from the sale of the secured property, to be able to look to other property of the debtor to discharge a debt which remains outstanding. It is quite another for a second mortgagee with no outstanding debt due from the mortgagor to be able to look to another property of the mortgagor to realise what it hoped to raise from the sale of the secured property. In my judgment, once there is no debt due from the mortgagor to the second mortgagee, the second mortgagee has no right to marshal. In this case, therefore, it follows that SOCA can have no right to marshal.

53. My conclusion receives support if one considers the position where the mortgagor is insolvent. As explained in paras 32-33 above, a second mortgagee, whose mortgage secured a debt due to him from the mortgagor would (if he could marshal) either be treated as a secured creditor whose security for the debt was the other property to the detriment of her unsecured creditors, or (if he could not marshal) would join the ranks of the unsecured creditors of the mortgagor's estate in respect of his debt. If a second mortgagee with no underlying debt from the mortgagor could in principle marshal, then, were the mortgagor to be insolvent, the

second mortgagee would either be treated, in effect, as a secured creditor whose security was the other property, whereas, if the second mortgagee could not marshal in such a case, it would have no claim at all against the mortgagor's estate. There would be nothing surprising about the latter possibility, whereas it would be surprising if marshalling could create what for all intents and purposes was a secured debt, when, in the absence of marshalling, there would be no debt at all.

54. My conclusion is also supported if the right to marshal is an incident of the second mortgage when it is granted, which appears to me to be logical and in accordance with the Judge's approach: – see [2010] EWHC 2570 (Ch), paras 27 and 37, as summarised in para 25 above. It is normally easy to imply a common intention on the part of the parties to the second mortgage (the mortgagor and the second mortgagee) that there should be a right to marshal where the second mortgage secures a debt due from the mortgagor, because such a right is to the manifest advantage of the second mortgagee and of no significance either way to the mortgagor (see paras 32-33 above). However, where there is no underlying debt due from the mortgagor (other than what the second mortgagee can extract from the common property), it would be plainly contrary to the mortgagor's interest that the second mortgagee should be able to marshal; accordingly, normal principle would suggest that, at least in the absence of special facts, there should be no right to marshal in such a case.

55. I should briefly revert to the notion that the absence of an underlying debt should be a factor which goes to the discretion of the judge when deciding whether to permit the second mortgagee to marshal, as suggested by the Court of Appeal at para 54 of its judgment. Not only does that seem to me to be wrong in principle, as already explained. It also appears to involve a recipe for uncertainty. Marshalling is an equitable right (or remedy), but that does not mean that its exercise should depend too readily on the individual merits of the case. It should, so far as possible, be governed by clear principles so mortgagors and mortgagees know where they stand.

56. Accordingly, I conclude that, where the second mortgage does not secure a debt owing from the mortgagor to the second mortgagee, the right to marshal should not normally exist once the common property is sold by the first mortgagee and the proceeds of sale distributed, because there would be no surviving debt owing from the mortgagor to the second mortgagee. In such a case, equity should proceed on the basis that the second mortgagee normally takes the risk that the first mortgagee will realise his debt through the sale of the common property rather than the sale of the other property.

57. I draw some support from the observation of Lord Eldon LC in *Kendall* 17 Ves 514, 527 that the doctrine of marshalling "has never been pressed to the effect

of injustice to the common debtor". Of course, this can be said to beg the question in the sense that it may be a matter of debate as to whether it would wreak an "injustice" on the mortgagor in a case such as this to permit marshalling. However, if one bears in mind that marshalling, as it has been understood normally, involves no net increase in the liability of the debtor/mortgagor when the second mortgagee's right of marshalling arises, I consider that the observation tends to support the notion that the doctrine of marshalling does not normally apply where the second mortgagee does not secure a debt from the mortgagor.

58. Finally on this aspect, I have intentionally used the word "normally" in paras 56-57 above, because marshalling is an equitable remedy. Accordingly, whether it is available in any particular case may depend on the circumstances, just as it may depend on the circumstances of a case where it would prima facie apply, whether it actually does apply. Notwithstanding what I have said in para 55, it would be wrong to rule out the possibility of an exceptional case, where the generalisations in para 56 or para 57 would not apply, although absent express words which permit or envisage marshalling, I find it hard to conceive of such a case.

59. As I understand it, if, as I have concluded, marshalling is not normally open to a second mortgagee where there is no underlying debt, SOCA does not contend that this is an exceptional case where it would be open to it. Therefore Mrs Szepietowski's remaining two contentions need not be addressed. However, it is right to express a view upon them, as they were fully argued and may be of some significance in future marshalling disputes.

The terms of the Settlement Deed and the 2009 Charge

60. If, contrary to the above conclusion, marshalling should be available to a second mortgagee where there is no underlying debt from the mortgagor in the same way as where there is such an underlying debt, I would still have allowed Mrs Szepietowski's appeal on the basis of the other contention advanced as part of the first strand of her argument.

61. As explained in para 25 above, the courts below approached the issue on the basis that marshalling should not be excluded unless the parties expressly agreed that it should be, or unless its exclusion was necessarily implied by the terms of the 2009 Charge. Marshalling is an equitable remedy or right, and it should not therefore be available to a second mortgagee in circumstances where it would be inequitable to allow it. While there is considerable overlap between the test applied by the courts below and inequitability, and while, as is reflected in para 55 above, any court must be careful to avoid an approach to equity which is too open-

textured or subjective, I consider that the approach of the courts below involved setting too high and too rigid a hurdle for a party seeking to mount a case against marshalling.

62. In my view, the correct approach is to ask whether, in the perception of an objective reasonable bystander at the date of the grant of the second mortgage, taking into account, in very summary terms, (i) the terms of the second mortgage, (ii) any contract or other arrangement which gave rise to it, (iii) what passed between the parties prior to its execution, and (iv) all the admissible surrounding facts, it is reasonable to conclude that the second mortgagee was not intended to be able to marshal on the occurrence of the facts which would otherwise potentially give rise to the right to marshal.

63. It is true that the possibility of marshalling can only arise some time after the mortgage is granted (and indeed that it may never arise), and it is true that facts could arise after the second mortgage which render it inequitable that the second mortgagee should have (or should not have) the right to marshal. However, it seems to me that the starting point for deciding whether there should be a right to marshal must be when the second mortgage is created. In the absence of relevant subsequent developments, the question must be judged as at that date. Furthermore, it appears to me to accord with principle that the question must be judged objectively, based on what passed between, was known to, and would consequently have been reasonably understood by, the parties.

64. In my view, a combination of factors in this case establish that, even if, given the facts summarised in para 22 above, the normal presumption would be that SOCA, as the second mortgagee, should be entitled to marshal, it should not be able to do so in this case.

65. First, the 2009 Charge was entered into to give effect to a claim under the 2002 Act. As Lord Carnwath points out in his judgment, ARA's (and now SOCA's) rights and powers are purely statutory in nature. For present purposes, its task under the 2002 Act was to identify, to claim and, through a court order, to obtain "recoverable property" – see sections 243, 266, 276 and 304-310. SOCA's rights under the 2002 Act were thus against specific assets of a respondent, and there could have been no question of a debt being created in favour of the ARA against a person such as Mrs Szepietowski, unless, of course, she had agreed to it, which, as explained above, she had not. Accordingly, it seems unlikely that the parties to the 2009 Charge could have intended SOCA to have a claim against a property which was not "recoverable" under the 2002 Act.

66. Secondly, there is the point that it would potentially be to the disadvantage of one of the parties to the 2009 Charge, namely Mrs Szepietowski, if the other party, SOCA, had the right to marshal. Of itself, this cannot be decisive, but, because there is no underlying debt from the mortgagor, this would make the normal presumption in favour of marshalling less strong than it would be in the normal case where there is an underlying debt due from the mortgagor. (This is not inconsistent with the point made in para 55 above, because, for present purposes, I am assuming, contrary to my earlier conclusion, that the absence of an underlying debt does not vitiate the right to marshal).

67. Thirdly, as explained in paras 7 and 8 above, Ashford House was included in Annexe A, but not in Annexe B or C, to the Settlement Deed, so it is clear that the parties intended it to remain with Mrs Szepietowski, unencumbered by any liability to SOCA. It would therefore be somewhat curious if the effect of the 2009 Charge, which was executed pursuant to the Settlement Deed, should have the result of encumbering Ashford House with a liability to SOCA.

68. Fourthly, in the Annexes, the parties did not treat Ashford House as subject to the RBS Charge, unlike Church Street, Thames Street and Claygate (see paras 8 and 9 above). Given that it is fundamental to SOCA's marshalling claim that Ashford House was subject to the RBS Charge, it is again somewhat curious that this claim arises out of a charge executed pursuant to a contract which plainly proceeds on the assumption that it was not.

69. Fifthly, particularly in the context of these three points, the fact that the Settlement Deed is expressed to be in full and final settlement of all claims SOCA may have relating to the properties in Annexe A (see para 8 above) is not entirely easy to reconcile with a subsequent marshalling claim by SOCA against Ashford House.

70. Sixthly, the effect of clauses 4.4 and 4.5 of the Settlement Deed, as explained in paras 11 and 12 above, is that Mrs Szepietowski would only have had to grant a charge over Claygate if three separate conditions were satisfied, namely (i) under clause 4.5(i), SOCA decided it wanted Thames Street and Church Street sold, (ii) under clause 4.5(ii), RBS refused to release those properties from the RBS Charge, and (iii) under clause 4.4, Mrs Szepietowski decided to have Claygate vested back in herself (as she could scarcely have granted SOCA a charge over a property it owned). If any of these three requirements had been unsatisfied, there would have been no 2009 Charge, and, of course, without that charge there would have been no possibility of marshalling, and therefore no possibility of SOCA claiming that any sum was secured in its favour over Ashford House. It seems particularly unlikely that SOCA's ability to mount such a claim would have been intended to depend on conditions (i) or (iii).

71. Seventhly, over and above these points on the contractual documentation, there is the point that Ashford House was Mrs Szepietowski's home. Common sense suggests that it was one of the relatively few properties in Annexe A which was not vested in the Trustee, because of that fact. The Settlement Deed represented a compromise which left Mr and Mrs Szepietowski with some properties, and it seems very likely that they would have been particularly keen to keep their home, and that SOCA accepted this in the Settlement Deed. That does not fit comfortably with the idea that SOCA and Mrs Szepietowski can have intended that a document subsequently executed pursuant to that Deed should lead to a substantial potential charge over that home.

72. In my view, the combination of these various factors establishes that, even if a second mortgagee whose mortgage secures no underlying debt from the mortgagor is entitled to marshal, the contractual documentation and background facts in this case establish that it would be inequitable for SOCA to be permitted to marshal against Ashford House. To permit SOCA to marshal would involve flying in the face of the understanding of both parties to the mortgage said to give rise to the right, namely the 2009 Charge, as revealed in the 2009 Charge itself, and the Settlement Deed from which it originates and indeed to which it refers in its preamble.

The second strand of Mrs Szepietowski's argument

73. Mrs Szepietowski contends that the fact that Ashford House is her home means that RBS would not, in reality, have been able to enforce its rights under the RBS Charge against Ashford House before it could have enforced its rights against Claygate. Accordingly, in reliance on the principle described in para 38 above and the Australian decisions there cited, *In re Holland* 28 SR (NSW) 369 and *Miles v Official Receiver* 109 CLR 501, she contends that marshalling would not, in any event, be available to SOCA.

74. This argument relies on two separate legal points. The first is the protection given by section 36 of the Administration of Justice Act 1970 ("section 36") to defaulting mortgagors of dwelling houses where the mortgagee is claiming possession. The second point is the respect which is afforded to an individual's home under article 8 of the European Convention on Human Rights ("article 8").

75. In my view, there is nothing in either of these points. The only thing which can be made of the fact that the marshalling claim relates to Mrs Szepietowski's home is the point made in para 71 above. Assuming in Mrs Szepietowski's favour that section 36 and/or Article 8 would have rendered it more difficult for RBS to enforce the RBS Charge against Ashford House than against Claygate, that would

be wholly insufficient to prevent SOCA being able to marshal, if it was otherwise entitled to do so. Where the requirements of the right to marshal are otherwise present, it would require a contractually enforceable obligation, or something close thereto, on the first mortgagee to enforce against the common property in priority to the other property for the second mortgagee to lose his right to marshal. (The words "or something close thereto" are added out of an abundance of caution, based on an acceptance that nobody can foresee every possibility: I find it very hard to think of an arrangement short of a binding estoppel which would do).

76. It would be wrong, both in principle and in practice, if it were otherwise. The right to marshal is based on a simple principle, and there is no reason to dilute it in the way contended for on behalf of Mrs Szepietowski. After all, the right to marshal is not based on the proposition that the first mortgagee is under an obligation to sell the other property first – see para 34 above. Further, if Mrs Szepietowski's contention were accepted, one can readily imagine all sorts of arguments as to whether one property is more difficult to sell than another, and whether the extent or nature of the difficulty is such as qualifies for the purposes of the contention.

77. Mr Tager QC suggested that if RBS had proceeded against Ashford House, the court would have stayed the proceedings on the basis that it should go against Claygate. I am by no means convinced that that is right. However, even if it was, I do not consider that would disqualify SOCA from seeking to marshal if it was otherwise able to do so.

Conclusion

78. In these circumstances, I would allow this appeal, and hold that SOCA does not have the right to marshal as it contends. I should add that, since preparing this judgment I have seen in draft the judgment of Lord Reed and the brief judgment of Lord Sumption, with both of which I agree.

LORD SUMPTION

79. I agree with the order proposed by Lord Neuberger for all the reasons that he gives. In particular I agree that subject to any contrary provision in the parties' agreement, the charge must secure one or more underlying debts (or other personal liabilities) of the chargor to the chargee before the latter can require it to be marshalled with other securities given to other chargees. The reason is that a charge to secure a liability of the chargor to the chargee is a secondary benefit. It is available only for the purpose of enforcing the primary benefit, namely the

underlying personal liability which the chargor owes him The right to marshall is an equity designed to ensure that the choices made by another chargee do not frustrate the enforcement of the underlying personal liability. If there is no underlying personal liability, then the sole effect of the transaction is to confer a contingent interest in the charged asset, not as the means to the recovery of any liability but as itself constituting the primary benefit. If the asset is subject to a prior charge in favour of someone else, the benefit thus conferred may not be worth very much. But that is the risk that the chargee necessarily accepts by taking no right of recourse against the chargor personally but only a potentially flawed interest in a specific asset. Once the chargee has enforced the charge against the asset in question, his claims against the chargor are exhausted. There is no possible equity that could entitle him to more. In this situation if the chargee can have the securities marshalled and proceed in addition against a different asset which was never charged to him, then the effect is to increase the chargor's financial exposure. Since this would conflict with the whole basis on which equity developed the right to marshall, I cannot accept that it represents the law.

LORD REED

80. I agree that the appeal should be allowed, for the reasons given by Lord Neuberger and Lord Sumption.

81. In view of the infrequency with which cases on this topic arise, and the application of the Proceeds of Crime Act 2002 throughout the United Kingdom, there may be some value in my adding some observations about the equivalent Scottish doctrine of catholic securities, described succinctly by Lord Adam in *Nicol's Trustees v Hill* (1889) 16 R 416, 421:

> "That doctrine is that when a prior creditor has one way of working out his preference which is less injurious to the postponed creditor than another, the prior creditor is bound either to adopt that course, or by assignation to put the postponed creditor into his right."

82. The equitable basis of the doctrine, as Lord Adam described it, was explained by Lord President McNeill in *Littlejohn v Black* (1855) 18 D 207, 212:

> "In the ordinary case of a catholic creditor – ie, a creditor holding security over two subjects, which for the sake of simplicity I shall suppose to be heritable subjects – and another creditor holding a postponed security over one of them, there can be no doubt that the catholic creditor is entitled to operate payment out of the two

> subjects as he best can for his own interest, but he is not entitled arbitrarily or nimiously to proceed in such a manner as to injure the secondary creditor without benefiting himself – as, for instance, capriciously to take his payment entirely out of the subjects over which there is a second security, and thereby to exhaust that subject, to the detriment of the second creditor, leaving the other subject of his own security unaffected or unexhausted. The second creditor will be protected against a proceeding so contrary to equity, and the primary creditor will be compelled either to take his payment in the first instance out of that one of the subjects in which no other creditor holds a special interest, or to assign his right to the second creditor, from whom he has wrested the only subject of his security."

83. Securities are neutral in their effect upon the debtor. Their effect is to strengthen the position of the secured creditor at the expense of unsecured creditors, since the holder of a security holds a right, accessory in nature, which he can exercise to secure the payment of the debt that is distinct from, and additional to, the right of action and execution which any creditor can exercise to enforce the performance of the debtor's personal obligation. The doctrine of catholic securities can therefore operate to the prejudice of unsecured creditors, but it cannot affect the interests of the debtor. As the Lord President stated (*ibid*):

> "The interest – ie the legitimate interest – of the primary creditor goes no farther than to get payment of his debt, and that is secured to him. The interest of the secondary creditor is to realize the value of his postponed security, and that is secured to him, in so far as is compatible with payment of the prior debt due to the primary creditor. The interest of the common debtor is truly nothing, or rather it is, or at least it ought to be, to allow both his creditors to receive full payment out of the subjects he had pledged to them."

84. The ideas underlying the Scottish doctrine evidently have much in common with those underlying the English principle of marshalling, as explained in the authorities cited by Lord Neuberger. Lord President McNeill's explanation that the Scottish doctrine protects the interests of the secondary creditor, but does not affect the interests of the debtor, appears to me to be equally true of the English principle, and to be particularly relevant to the present case.

85. As Lord Neuberger has explained, the debt which was owed to SOCA and secured by the 2009 Charge was contingent upon a number of eventualities, one of which was whether any amount (and if so, how much) was left over after prior claims had been met out of the net proceeds of sale of Claygate: something which depended upon RBS's decision as to the order in which it should realise its

securities. It follows that the short answer to SOCA's claim that it should be entitled to the benefit of RBS's security over Ashford House in order to secure the payment of the balance of the debt owed to it is that there is no such balance: it received, out of the sale proceeds of Claygate, all that it was entitled to receive. SOCA's argument to the contrary assumes, contrary to clause 7.2 of the 2009 Charge, that there was a debt owed to SOCA which was ascertainable independently of RBS's election. Another way of putting the point is to say that there is no scope for marshalling of securities, as SOCA is no longer a creditor of Mrs Szepietowski, and there is therefore no longer any personal liability which is secured by the 2009 Charge.

86. It is because of the debt's being contingent upon (amongst other things) RBS's decision as to the order in which to realise its securities that SOCA's argument is inconsistent with the principle that marshalling is neutral in its effect upon the debtor. If SOCA were entitled to treat the balance of the Secured Amount (as it was somewhat confusingly described in the 2009 Charge) as being secured over Ashford House, the effect would be to increase the amount which Mrs Szepietowski had to pay: in the light of clause 7.2, it cannot be argued that, absent marshalling, SOCA would be a creditor for the balance of the Secured Amount. That in itself demonstrates that SOCA's claim is not a proper application of the principle of marshalling.

LORD CARNWATH

87. I agree that the appeal should be allowed, but on narrower grounds than those favoured by Lord Neuberger. In my view the solution is to be found, not in the general law of marshalling, but in the interpretation of a particular contract against its unusual statutory and factual background.

88. On that aspect, I agree with the conclusion and much of the reasoning of Lord Neuberger under the heading - "The terms of the Settlement Deed and the 2009 Charge" (paras 60-71), but with a rather different emphasis. The starting point to my mind is the statutory jurisdiction under which SOCA was operating, and under which the compromise was agreed. SOCA's jurisdiction under this part of the 2002 Act is asset-based, rather than financial. Its task is to identify and claim "recoverable property", that is property acquired through unlawful conduct as provided for in the Act. The essential purpose of the settlement deed was to resolve a dispute between SOCA and the appellant as to the properties to be treated as falling within that category.

89. It was consistent with that scheme that the appellant did not undertake a personal obligation to pay any sum of money as such, beyond the value of her interest in the properties specified. SOCA started with a potential claim to 20 items of recoverable property (listed in annexe A) but they agreed to accept the 13 "transfer properties" listed in annex B in "full and final settlement" of their claims "in relation to" all the properties in annexe A" (cl 2.1), they being expected at the time to realise some £5.4m. Her home, Ashford House, was specifically excluded.

90. As I understand the arrangement, the two additional properties in annexe C (Claygate) were needed solely to deal with the complication of the RBS charge over two of the transfer properties (Thames Street and Church Street). If RBS had agreed to the transfer of their charge to Claygate (under cl 4.5(i)), there would have been no such complication, the additional properties could have dropped out of the picture (cl 4.4), and no question of marshalling could have arisen. As it was, the trustee's rights to Thames Street and Church Street were, on their sale, converted into another property right, a charge over Claygate for the amount (£1.24m) of their sale proceeds as paid to RBS (cl 4.5(ii), 2009 charge cl 1).

91. Consistently with the scheme of the settlement, clause 2 of the charge defined the appellant's obligation on sale of that property as being to "apply the proceeds of sale.., in settlement of the secured amount". In this statutory context, and taken with clause 7.2, I read this wording as not only excluding any personal liability on the part of the appellant, but as also impliedly excluding recourse to any source for payment other than those identified. If SOCA had wished to include Ashford House as potentially recoverable property, they should have done so specifically, rather than hope to bring it in later by an equitable backdoor.

92. In the result, I agree with Lord Neuberger's conclusion at paragraph 72, not so much on the basis that it would be "inequitable" to allow marshalling against Ashford House, but that on the proper interpretation of the agreement in its statutory context that possibility is excluded.

93. This conclusion accords with that provisionally reached by Henderson J in his first judgment ([2009] EWHC 655 (Ch) para 31). In his later judgment on the present issues ([[2010] EWHC 2570 (Ch) paras 35-36) he changed his mind. He thought that clause 2.1 could not be read as extending to "future claims against or relating to the released properties". He took account of some words of Lord Bingham of Cornhill in *Bank of Credit and Commerce International SA v Ali* [2002] 1 AC 251, para 19 ("the *BCCI* case"), when holding that the general release arrived at in a settlement agreement in that case did not extend to future claims for stigma damages by BCCI employees who had been made redundant in 1990. In the Court of Appeal, Patten LJ agreed. He said:

> "The claim to be subrogated to the RBS charge against Ashford House is not a claim against Mrs Szepietowski in the proceedings or even a claim against her at all. It is a claim to enforce the subsisting clause 4.5 charge by invoking the court's equitable jurisdiction to marshal the available security between existing creditors. Clause 2.1 is not directed to that issue which arises as a result of rights granted to SOCA under the deed." (para 47)

94. With respect to both courts, I think that Henderson J's first thoughts were correct. The marshalling claim is sufficiently linked to the subject matter of the agreement to fall within the words of clause 2.1, in the context of an agreement which, as I have said, was intended to define the limits of SOCA's property claims arising out of these particular allegations of unlawful conduct, and in relation to these properties.

95. This is a very long way from the facts of the *BCCI* case. As the judge acknowledged, and as is apparent from Lord Bingham's words quoted by him, that was a case in which the parties, at the time of the release, "could never have had in contemplation at all" the type of claims subsequently advanced. Furthermore, with respect to Patten LJ, to focus on whether the marshalling claim is one "against Mrs Szepietowski" herself is to disregard the whole purpose of the agreement, which as I have said was not to define personal claims, but to fix the limits of SOCA's property claims under the Act. The addition in clause 2.1 of the words "(claims)… in relation to the properties … listed…" seems to me quite sufficient, if necessary, to make that clear.

96. I would have been content to stop at that point. But in view of the attention given to the issue of marshalling in the courts below, and since I have reservations about Lord Neuberger's reasoning on this topic, I think it right to add my own comments.

97. The courts below struggled with the concept of a charge without an underlying debt, which the judge described as a "contradiction in terms" (para 45). He referred to Lord Hoffmann's statement that an interest provided by way of security entitles the holder to resort to the property "only for the purpose of satisfying some liability due to him (whether from the person providing the security or a third party)…" (*In re Bank of Credit and Commerce International SA (No 8)* [1998] AC 214, 226 ("the *BCCI (No 8)* Case")).

98. This discussion arose in the context of what he called the "two debts condition" (para 47). This, as I understand it, he took from the statement of Rose LJ in the Court of Appeal decision in the *BCCI (No 8)* Case [1996] Ch 245, 271 (in

the passage already quoted by Neuberger LJ para 2) that “for the [marshalling] doctrine to apply there must be two debts owed by the same debtor to two different creditors”. It was argued that since there was no debt due to SOCA, marshalling could not be invoked. The judge concluded that this condition was satisfied, even if the appellant could not be sued personally:

> “That there was a debt owed by her to SOCA is in my judgment undeniable, even if it was a debt that could be enforced only by sale of the Claygate Properties” (para 46).

In the Court of Appeal, Patten LJ (paras 53-54) recorded that there had been no challenge to the judge’s finding that a debt was created by the charge. Nor was this issue as such reopened by the appellant’s printed case in this court (see para 154).

99. Notwithstanding that formal position, the majority of this court have as I understand it thought it appropriate to re-examine the no debt issue, in order to avoid the law being developed on a false basis. I do not dissent from that approach, although I am not convinced that the issue is one of any general importance. On any view, the concept of a charge without an underlying personal debt seems sufficiently unusual for it to be difficult to consider outside the particular factual context in which it may arise.

100. As to the principle, I agree with Lord Neuberger (para 48) that Rose LJ’s words were not directed to the issue which arises in this case. They cannot in my view be read as sufficient in themselves to establish a general “two-debts” rule. I do not find it so easy, however, to discount the words used in the 18th and 19th century authorities, since it is they which explain the basis on which the principle was developed.

101. Those cases make clear to my mind, as Miss Harman submits, that it is a remedy which operates primarily between security holders, not between them and the common debtor or chargor. In the words of Lord Eldon LC in *Aldrich v Cooper* 8 Ves Jun 382, 395 (quoted by Lord Neuberger at para 30) “a person having [access to] two funds shall not by his election disappoint the party having only one fund…”; or as Professor Story put it (quoted at para 35) it is a matter of “natural justice” between the two creditors. To achieve this, the second charge-holder has “an equity to require that the first creditor satisfy himself (or be treated as having satisfied himself) so far as possible out of the security or fund to which the latter has no claim” (per Lord Hoffmann in the *BCCI (No 8)* Case [1998] AC 214, 231, quoted at para 1). The Scottish cases, to which Lord Reed refers, are to the same effect.

102. With regard to the interests of the common debtor or chargor, the only qualification to be found in those judgments is in Lord Eldon LC's observation in *Ex P Kendall* 17 Ves 514, 527 that the principle "has never been pressed to the effect of injustice to the common debtor" (quoted by Lord Neuberger at para 37). However, it is not clear what form of injustice he had in mind. In the normal case, the common debtor will have accepted the risk of enforcement of the two charged sums in full against both securities. There is no injustice to him if that risk becomes fact. That position, as it seems to me, is unaffected by whether or not the charger is also subject to a personal liability. In either case, he has accepted the risk of enforcement against both properties, contingent only on the choice of the first chargee.

103. Lord Neuberger's view to the contrary depends as I understand it on looking at the position after the common property has been sold by the first chargee (paras 46-47). However, that seems to me with respect to look at the position from the wrong end. What matters is not how things turn out, but whether that result is within the scope of the risk which the chargor has undertaken at the time the charges were granted. Clearly, once the common property is sold, assuming the chargor is solvent and there is no personal liability, he will be worse off if marshalling is allowed than if it is not. Instead of enforcement being limited to what can be extracted from the second property, it will extend to the remaining value of both properties. However, there is no injustice in that result if it is within the scope of the risk which he has voluntarily accepted.

104. On the wider issue, therefore, I agree with Miss Harman's submissions. Assuming that, at least in theory, there might be other circumstances (outside the present statutory context) in which a charge would be granted without an underlying personal liability, I see no reason in principle why the remedy of marshalling should be excluded.

105. However, for the reasons already given, I would uphold the appeal on the issue of construction.

LORD HUGHES

106. I entirely agree that this appeal should be allowed and that on the facts of this transaction SOCA does not have the right to marshal against Ashford House. With a single exception, I do so for all the reasons given by Lord Neuberger.

107. The single exception concerns the general proposition that before marshalling can be claimed the security held by the second chargee must secure an

underlying personal debt of his to the chargor. It seems to me, as it does to Lord Carnwath, that the essence of marshalling lies in the existence of concurrent securities, rather than in the nature of the liability which they secure. Clearly there will always be some liability by the chargee to the chargor. It will normally, no doubt, be a personal debt from the chargee to the chargor. But it may occasionally be something different, as for example if the chargor is prepared to underwrite the debt of another to the extent of putting up security but is not prepared to enter into an unlimited personal guarantee. If, in such a situation, the security offered is a second charge on some asset (Blackacre) already charged to a prior chargee and if that prior chargee also has additional security (Whiteacre) for whatever liability the chargor has to him, the occasion for the second chargee to seek to marshal may arise if the prior chargee opts to enforce the common security (Blackacre) rather than his additional security (Whiteacre). There may be something in the particular transaction, as there is here, which demonstrates that marshalling would be inconsistent with its nature. But as a general proposition it seems to me that there is no obstacle in the situation described to the second chargee marshalling against Whiteacre up to the amount which would have been available to him in Blackacre if the prior chargee had opted to enforce first against Whiteacre. True it is that the second chargee has always known that he ranks second to the prior chargee and that accordingly he has always faced the risk that Blackacre may be used up by the prior chargee. But that is true equally where there is also a personal liability. The function of marshalling is to avoid his losing his security simply because the prior chargee opts to enforce against Blackacre rather than against his additional security, Whiteacre. The existence or non-existence of a personal liability in the chargor makes no difference. Next, it is certainly true that it is of the essence of marshalling that it is neutral so far as the chargor/debtor is concerned, in the sense that he ends up paying in total out of the two securities no more than he was always liable to pay. However, it does not seem to me that the chargor's total exposure is impermissibly beyond what it was always likely to be by marshalling in the situation described. It will still be the same as it would have been if either (a) the prior chargee had enforced first against Whiteacre or (b) the liability to the prior chargee had otherwise been discharged, both of which events were always on the cards.

108. For these reasons, although the occasion for the distinction to bite will no doubt be rare, I prefer Lord Carnwath's conclusion on this narrow point.