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from 1675 helps
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December 2010

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Introduction

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Advocate John T Ayccock reviews

A landmark case in the Isle of Man, using an equitable principle dating back to 1675.

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Equitable principle from 1675 helps supermodel win landmark case in Isle of Man

Australian supermodel Elle Macpherson has won a landmark victory in an Isle of Man High Court insolvency case using an equitable principle dating back to 1675.

Facts

Miss Macpherson had been a customer personally of Kaupthing Singer and Friedlander (Isle of Man) Limited (“KSF” or “the bank”) when it went into liquidation in May 2009. She also had an Isle of Man company called Light House Living Limited (“LHL”) which owed KSF £7.8 million in respect of a mortgage for residential property in London (“the property”). Miss Macpherson guaranteed the repayment of LHL’s money to the bank and the property was acquired and held by LHL as nominee and trustee for Miss Macpherson. She occupied the property as her home in England.

When KSF went into liquidation whereas LHL owed £7.8 million to KSF in respect of the mortgage loan, the bank itself owed Miss Macpherson approximately US\$4 million (then equivalent to some £2.5 million) in respect of deposits.

Law

As a result of the winding up order made by the Isle of Man High Court on 27 May 2009 the effect of the insolvency set off provisions in section 22 of the

Bankruptcy Code 1892, as applied to company windings up by section 248 of the Companies Act 1931, fell to be considered by His Honour Deemster Moran. The liquidator of KSF was the claimant in the proceedings and sought a declaration that Miss Macpherson’s US dollar deposits could not be set off against the mortgage debt LHL owed to the bank. Miss Macpherson contended that section 22 of the Bankruptcy Code 1892 applied to the dealings between the bank, LHL and herself with the result that the sum due to her from the bank in respect of the deposits was automatically set off against the sum due from LHL to the bank in respect of the mortgage loan. Miss Macpherson therefore contended that only the net balance of some £5.3 million (£7.8 million less her deposit of £2.5 million) was due from LHL to the bank.

The material part of section 22 of the Bankruptcy Code 1892 is:

“22 Mutual credit and set off

Where there have been mutual credits, mutual debts, or other mutual dealings between a debtor against whom an Order of Adjudication shall be made under this Act, and any other person proving or claiming to prove a debt under such Order, an account shall be taken of what is due

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from one party to the other in respect of such mutual dealings, and the sum due from one party shall be set off against any sum due from the other party, and the balance of the account, and no more, shall be claimed or paid on either side respectively.”

The liquidator contended that section 22 did not apply and there was no set off as the parties were distinct. The liquidator said that LHL was bound to repay the full £7.8 million to the bank while Miss Macpherson could prove in the liquidation in respect of the £2.5 million due to her and receive whatever dividend is ultimately paid.

In October 2009 LHL sold the London property for £6.4 million with the consent of the KSF liquidator. The terms of the sale were that the net sale proceeds less the personal deposit (as if set off had taken place) would be paid to the liquidators. The balance was held by English solicitors pending determination of the dispute.

Deemster Moran identified the principal battle ground before him as being the equitable set off argument. In his judgment he cited that section 22 of the Bankruptcy Code 1892 was the same form and language as its equivalent UK

predecessor and successor provisions and had several commonwealth cousins. Notwithstanding this and the long history and wide geographical incidence of the provision, the point which fell for decision by him in relation to the equitable set off argument had never arisen before in another relevant jurisdiction.

Miss Macpherson’s legal team contended that it was she, and not LHL, who should be regarded as the real party with whom the bank was mutually engaged in these dealings. Notwithstanding the interposition of a nominee and trustee to borrow from the bank to legally acquire the property and assume its mortgage liability, Miss Macpherson’s team said she was the real party with whom the bank was mutually engaged. It was argued that Miss Macpherson was the one who was beneficially entitled to have the debt owed to her based on her deposits set off in full against the legal indebtedness of LHL to the bank. Deemster Moran was ultimately convinced that Miss Macpherson and her company were in equity one and the same.

The Deemster made it clear that on the equitable set off argument he was exercising the jurisdiction founded in equity and which had been fashioned and used from the earliest times “to do

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substantial justice between the parties”. He expressed his view that if Miss Macpherson failed to secure a set off because of the interposition of LHL then it would be a “*purely inadvertent technical legal consequence of her reasonable wish to preserve her anonymity in ownership of property which the bank in promotion of its business and the making of its profits was entirely happy to go along with knowing that the money was still to be loaned entirely and exclusively for the benefit of Miss Macpherson and that it would be wholly repaid by her through her nominee upon realisation of her beneficially owned assets, purchased and improved with that money.*”

Deemster Moran then conducted a review of the ancient authorities on the equitable argument. He cited *Bailey v Finch* [1871] LR 7 QB 34 which itself referred to the rule of mutual credit dating back to authority from 1675. The 1871 extract in the judgment from *Blackburn J* cited two cases then stated: “*Now those two cases, before the Revolution, and before there had ever been a Statute of Set Off, shew (sic) that at that time the most equitable principle was adopted that the cross accounts should be set off one against the other, and that the balance only should be proved. That was enacted in the Statute of 4 Anne c.17 s.11 was*

continued afterwards in other statutes, and is continued now.”

Deemster Moran stated that he had to look at the equitable or beneficial interests to determine if the credits, the debts or the claims are between the same persons or parties and in the same interests. He concluded “*I am satisfied...that the equitable or beneficial interest in the credit deposit with the bank and the equitable or beneficial interest in the liability to the bank, in the sense contemplated by this provision properly understood are completely reciprocal, countervailing and in the same person or party namely Miss Macpherson.*”

To that extent Deemster Moran said that it was abundantly clear that a strict literal interpretation of section 22 of the Bankruptcy Code was entirely inappropriate. He said the provision had an extremely longstanding clear and definite purpose of enabling and requiring a court exercising bankruptcy jurisdiction to do substantial justice between the parties to mutual dealings upon the insolvency of either of them. He gave the provision a purposive construction. He said “*I can see no reason in principle for treating a party who acquires beneficial entitlement to property or performance of an obligation to a legal undertaking of his*

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trustee with another party, differently in the exercise of this jurisdiction, to a party who is a beneficiary and has his trustee undertake a legal obligation to deliver a reciprocal benefit to that other party, which in reality, truth and substance is to be delivered by the beneficiary.”

The Deemster went on to say that the dealing began with two parties just the bank and Miss Macpherson. Both parties agreed to interpose LHL on one side on the account but the real and substantial parties to the transactions remained the bank and Miss Macpherson. Accordingly Deemster Moran found in favour of Miss Macpherson being entitled to the relief claimed in her counterclaim.

Comment

As well as giving us an insight into how wealthy supermodels may be, this case is significant on a number of fronts. The following points spring to mind (there are others):

1. This is another reminder that distinct legal entities and the company's separate legal personality are not set in stone when it comes to debts owing in an insolvency;
2. Never ignore old cases or principles

– some are equally applicable today it seems, even if over 300 years old;

3. Insolvency and banking practitioners may have to think twice about lending arrangements made for an individual which interpose a company belonging to that individual;
4. Watch this space if the decision goes to appeal.

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